After The Storm: The Future Face of Europe's Financial System

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Lamfalussy's initial remarks

Just for the record. As some of you know, I am chairing a Committee which advises the Belgian Government on reforming our financial architecture. I am speaking here in a personal capacity - not in the name of my Committee.

Let me state from the outset that I support the de Larosière Group's (DLG) proposals regarding the re-design of the European financial supervisory architecture. Admittedly, my preference (which I made clear *in tempore non suspecto* in my 2004 Pierre Werner Lecture and have repeated ever since on numerous occasions) is for granting the ECB an operational co-responsibility for the supervision of the 45 large European banking groups which are the ones that crucially matter if we want to prevent that crisis manifestations turn into a full blown systemic crisis.

Regretfully, I am aware that despite the severity of the current financial crisis and its sharply increasing deleterious impact on the "real" economy, the chances of such a proposal being accepted are at present negligible. At the same time the proven incapability of our supervisory and regulatory structures to prevent (or at least mitigate) a serious crisis cries out for repair and, moreover, for urgent repair. Hence my approval of the core of the DLG proposals which offer a less radical but probably still efficient reform path – on two conditions.

One is that the proposals are accepted speedily, and that there is a beginning of the reform process. If this is *seen* happening, the much needed confidence building effect would be helpful not only for the distant future, but also for the management of the current crisis.

The other condition is that the implementation of the DLG proposals is carried out with utmost care, and with a sharp eye on the practicalities. Let me briefly explicit some components of this second condition.

The macro-prudential crisis prevention process comprises three stages. The first is the collection of information which may be signaling developments in banks, financial intermediaries and markets that could give rise to crisis manifestations. The potentially most valuable source for this kind of information is micro-prudential supervision. But since micro-prudential supervisors are neither trained, nor mandated, to detect such crisis signals, macro-prudential supervisors – coming from ECB/Eurosystem – should be sufficiently closely associated with the "traditional" supervisory activities to be able to identify any such crisis signals. This point is made clearly by DLG, but I would recommend to watch carefully the practical implementation.

The second stage is (a) the pooling of the information collected at the level of systemically significant individual banking groups and (b) the analysis of the aggregated – I would even say consolidated – figures. This is a very demanding exercise, and I can easily visualize the obstacles – ranging from legal impediments to instinctive information retention – that would have to be overcome. Yet, without an effective pooling of information and a scrupulously independent analysis, the European Systemic Risk Council will not be able to do its job. It is obvious that neither the pooling, nor the analysis can be carried out by the members of the Council. And not even by their deputies or alternates who, I presume, would be

meeting occasionally. Both the pooling and the analysis has to be undertaken by a highly competent group of full time specialists working under strict conditions of confidentiality. The ECB would have to play a key role in setting up and organizing the work of this team. This is how I prefer to understand Recommendation 16 of DLG: "A new body called the European Systemic Risk Council (ESRC), to be chaired by the ECB President, should be set up *under the auspices and with the logistical support of the ECB"* (ital. mine).

The third stage is the functioning of the risk warning system, under the auspices of the ESCR (and the EFC), which, naturally, has to consider the recommendations made by the team of officials just mentioned. This is a crucial part of the proposals: what has been missing so far has not only been the lack of information, of the pooling of information and of its analysis, but also the *lack of policy reaction.* The functioning of the ESCR therefore deserves close scrutiny. What will be the voting procedure? What contains the box of policy tools that can be triggered by the ESCR? What policy tools are at the disposal of which authorities? How can be ensured that the speed of policy reactions is proportionate to the degree of systemic danger? There are surely other matters to be looked into, but out of respect for the time limit for this initial statement I have to stop here.

I would just conclude by insisting on the urgency of formally adopting the core proposals of DLG relating to the re-design of the European supervisory and regulatory structures. We all know that a number of other decisions will have to be taken at the global level – but this is no reason for not speeding up the reform process of our European structures. On the contrary, the bargaining position of Europe vis-à-vis our partners can only be enhanced by demonstrating our ability to act decisively. It would be irresponsible to miss this opportunity. All the arguments are in favour of speed; none in favour of procrastination.

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