Abstract

Models of EU financial market supervision

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This paper seeks the optimal way of supervision of a single EU financial market. The reason for my research is that, based on the development of financial markets in recent years, the interconnection of markets, modern investment instruments and the strengthening of multinational financial groups allow for quick and easy transfer of capital and risk between countries and financial sectors. This forces us to reconsider the appropriateness of the currently used supervisory model. The paper analyzes models of home state supervisor in connection with supervision on a consolidated basis and supervision of financial conglomerates, the model of a lead supervisor and a single supervisor model with the unified structure and dual structure with the Union and national supervisory authorities. As the evaluation criteria were chosen costs for financial institutions, supervisory effectiveness, consumer confidence and political acceptability. The analysis concludes that the most appropriate model of supervision of a single financial market of the European Union is the model of a single supervisory authority with the unified structure.

The work is divided into eight chapters to present reasons why the issue should be examined, analyzed possible solutions and evaluation of analysis. The first chapter describes the reasons why it is necessary to oversee a single financial market in the European Union. These are the integration of a single financial market of the European Union, achieved through the Financial Services Action Plan, and investment instruments for the transfer of credit, insurance and market risks allowing shift of significant financial risks between different financial sectors, entities within financial groups and between the states of the European Union.

The second chapter sets out the objectives to determine the optimal supervisory model. It lists the interests of financial institutions, supervisors and consumers in the financial markets, the risks of integration and requirements, which a supervisory authority must comply with. In evaluating whether to use public or private oversight based on self-regulation, the paper concludes that, in light of historical developments in individual member states, the

limited capacity of consumer organizations to protect consumer interests in the financial market and the limited enforcement of law in some member states, the most appropriate form is the public service model that will be supported to a limited extent by private organizations. At the end of the chapter, the evaluation criteria are set based on supervisory objectives and interests of participants: costs for financial institutions, supervisory effectiveness, consumer confidence and political acceptability.

The third chapter deals with the model of a home country supervisor, which is currently used to supervise the financial market in the European Union. The model is built on the premise that each service provider has its own home state, in which he obtained permission for its activities and which oversees its activities. This state is unique for each service provider. In contrast, the state in whose territory the service provider operates, either on the basis of the establishment, or simply cross-border provision of services without establishment, is the host state. This model opened up markets in individual member states to the regulated entities from other member states and triggered a genuine integration of financial services. Practical application of the model, however, brought problems in determining the scope of competences of the member states, the lack of harmonization of regulation and supervision at the local level, the need to communicate with several supervisors and the resultant costs, and the cross-border supervision of branches but not the subsidiaries.

The home country supervisor model used on an individual basis is for supervision of financial groups supplemented by consolidated supervision of credit institutions, investment firms and insurance companies and supervision of financial conglomerates, which the fourth chapter deals with. The reason for the supplementary supervision is the contagion risk within a group, the group's exposure to counterparties, transparency, legal and management structures, monitoring the quality of the management, access to information for prudential supervision and moral hazard. Supplementary supervision has particularly the coordinating function for the supervision of entities in various states and does not substitute the supervision on an individual basis.

The fifth chapter analyzes the model of a lead supervisor, which was introduced by market participants to eliminate the disadvantages of the home state supervisor model. It gives powers to oversee the entire financial group to an only supervisor, regardless whether entities are established on the territory of another member state through a branch or a subsidiary. Supervisory authorities in host countries are losing their supervisory powers, and only operate within the so-called college of supervisors, which serves as an advisory body to the lead supervisor and also works as a forum for information exchange. This model seems to be applied more widely in the future.

Another possible solution is the model of a single supervisory authority for the entire European Union, further discussed in the sixth chapter. That would eliminate the disadvantages arising from the relationship between home and host state, strengthen the legal certainty for regulated entities, ensure the concentration of information on all subjects within a supervisory body and facilitate both the resolution of financial crises and negotiations with third parties. It can operate under a unified organizational structure where national supervisors would be branches roofed with Union headquarters or alternatively as a dual system where supervision is provided by both a single union supervisory authority and national supervisors. Supervised entities would be always supervised only by one authority, depending on whether they provide services across borders or not. Actually, overall application of this model meets resistance from member states; however, this model is going to be introduced for the supervision of credit rating agencies.

The seventh chapter describes recent developments and changes in financial market supervision on the pan-European level. In response to the dramatic developments on financial markets in 2007 and 2008, a group of experts proposed a new system of EU financial market supervision which was subsequently adopted by EU institutions. There is a newly established authority for the supervision of systemic risk and three European supervisors divided according to sector principle. Nonetheless, new authorities are regulatory rather than supervisory in nature and their contribution should be mainly in the convergence of supervisory practices in member states. In this connection, many decisions of new authorities are binding and at the expense of national sovereignty.

The content of the eighth chapter is to evaluate the analyzed models and to describe their possible risks for the Czech Republic. The thesis concludes that the highest possible effectiveness of supervision cannot be achieved by using more than one supervisor. Only when applying the model of a single supervisor with the unified structure no different supervisory approaches between authorities apply and there is no loss of efficiency due to the

administrative burden of having to cooperate and exchange information. Moreover, this model delivers the lowest cost associated with supervision for regulated financial institutions.

The tested models bring certain risk due to the structure of the financial market in the Czech Republic, where the dominant financial sector is the banking sector, in which approximately 98 % of the total assets is in hands of foreign owners, more than 90 % of which is from the Union. Therefore, introduction of the lead supervisor model would result to the loss of supervisory powers for more than 90 % of the systemically most important financial sector and the Czech Republic would participate in supervision solely as a member in a college of supervisors. In addition to this, given the differences in the systemic importance of the subsidiary in the Czech Republic and the parent company for a lead supervisor, the intensity of surveillance could be reduced and if the financial stability would be endangered interests of another Member State over the interests of the Czech Republic might prevail. The model of a single supervisor presents only a lower risk. Therefore, for the Czech Republic itself, disregarding its interest in the efficient functioning of the Union, may be worth keeping the current model of a home country supervisor, where the individual financial institutions in the Czech Republic are being supervised according to their importance for the Czech national economy, the impact of their failure for the state budget, guarantee schemes and lender of last resort. At the same time, it should continue the supervisory convergence and cooperation among supervisors in the Member States.

Keywords: supervision, financial market, European Union