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Article
A Proposal for the Governance of Financial Regulation and Supervision in Europe

Vierteljahrshefte zur Wirtschaftsforschung

Provided in Cooperation with:
German Institute for Economic Research (DIW Berlin)


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A Proposal for the Governance of Financial Regulation and Supervision in Europe*

By Armin J. Kammel**

Summary: Financial markets underwent significant changes worldwide within the last decades. Structural changes involving traditional operators led to modifications of the regulatory as well as supervisory settings of the financial system. Therefore, the paper tries to find a solution for a proper and well functioning regulatory and supervisory framework for the European single market. In this context, some pragmatic ideas regarding the reorganization of the regulatory arrangements and supervisory settings of financial markets in the European Union are presented. Moreover, the paper tries to point out that it is too early to establish a single European supervisory authority. As the paper shows, it might be useful to make use of the gradually implemented Lamfalussy architecture and simply add one more committee which has the task to coordinate the activities of the four within the Lamfalussy architecture proposed committees. The institutional design of this committee is quasi-centralized. The advantage of the proposal is that the institutional framework is characterized by a high degree of flexibility, meaning that its institutional arrangements can be transformed into a centralized supervisory authority and that it is cost-efficient since it is partly based on partly already existing structures.


* This paper's findings, interpretations and conclusions are entirely those of the author and do not necessarily represent the views of the VOEIG.

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1 Introduction

Financial markets underwent significant changes worldwide within the last decades. Structural changes involving traditional operators in particular in the field of banking, also affecting investment firms and insurance companies led to modifications of the regulatory as well as supervisory settings of the financial system. This paper solely focuses on the European perspective and tries to find a solution for a proper and well functioning regulatory and supervisory framework for the European single market. Primarily, it is important to stress the distinction between regulation and supervision which is often mixed up in this context. Basically, regulation deals with the formation of rules that are on the one side part of the legislation and thus are approved by national Parliaments and on the other side rules that are implemented by administrative bodies. Contrary to this, supervision deals with the enforcement of the rules, either \textit{ex ante} in the sense of control or \textit{ex post} in the sense of sanctions.\footnote{A useful definition of supervision as a process with the four phases being licensing, supervision \textit{stricto sensu}, sanctioning and crises management is provided by Lastra (1996).} Moreover, the objective of this paper is to present some pragmatic ideas regarding the reorganization of the regulatory arrangements and supervisory settings of financial markets in the European Union. Furthermore, it is intended to contribute to the ongoing debate on the future European financial architecture as well as on the possible need of centralization of supervisory functions.

The paper is organized as follows: After giving a short overview of some theoretical models on financial regulation in Section 2, I will elaborate on a proposal for a new configuration for supervising both, the national as well as the supranational financial market(s) by trying to fulfil the three necessary objectives being stability, transparency and competition. When discussing this proposal, Section 4 will not make a clear distinction between centralized and decentralized regulation, since it is considered as to be useful to have a combined approach in order to make the regulatory framework more efficient. Nevertheless, I will clearly point out which institution has to take care of financial stability from a macroeconomic point of view at the supranational level. The paper will be concluded by Section 5, pointing out the main conclusions as well as giving a possible outlook of the future European financial architecture.

2 Various Approaches to Financial Market Regulation and Supervision

2.1 Financial Market Regulation

Financial market regulation is one outflow of public intervention in economic matters which is generally based on the need to correct market imperfections and unfair distribution of resources. Therefore, the regulation of the financial system can be viewed as a particularly important case of public control over the economy (Di Giorgio and Di Noia 2002: 4).

However, what are the objectives of financial market regulation? In general, the term financial market includes the banking, financial and insurance segments. The original distinctions between these various markets were mirrored by the regulatory structure with different agencies for banks, which are in most cases the central banks, securities and in-
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Insurance firms at both the national as well as the international level. Since, as Corrigan (1987) nicely stated it, the bounds dividing the various types of financial institutions are becoming increasingly blurred, the financial market can be considered as an economic space wherein operators of various kinds, such as banks, financial intermediaries, mutual funds, insurance companies, or pension funds, offer financial instruments and services. Taking this into account, the primary objectives of financial market regulation are as follows: (i) the pursuit of macroeconomic and microeconomic stability, (ii) transparency in the market and of intermediaries and therefore improving investor protection and (iii) safeguarding and promotion of competition in the financial intermediation sector.

2.2 Financial Market Supervisory Models

After generally elaborating on the objectives of financial market regulation, it is important to shift the focus on institutional matters. In this context it has to be stated that neither one unique theoretical model nor just only one general approach to the regulation and supervision of financial markets exists. As Di Giorgio and Di Noia (2002: 6–11) show, the various existing institutional approaches can be divided into four categories: “institutional supervision”, “supervision by objectives”, “functional supervision” and “single-regulator supervision”.

The so-called institutional approach, which basically follows the traditional segmentation of the financial system into three markets – banks, financial intermediaries and mutual funds as well as insurance companies – seems to be outdated in particular if one takes the fairly obvious trend toward multiple-sector activities and the progressive de-specialization of financial intermediaries into account. These phenomena, leading to the establishment of large financial conglomerates can hardly be combined with an institutional setup that stresses the boundaries separating the various institutions because that causes the risk that “parallel” systems of intermediaries may be created which rather leads to instability than stability of the institutional control framework.

The “supervision by objectives” approach is based on the idea that all intermediaries and markets are subject to the control of more than one authority, whereas each single authority is responsible for one objective of regulation regardless of both the legal form of the intermediaries as well as the functions or activities they perform. The advantage of this approach which was for example chosen in Australia is that it is particularly effective in a highly-integrated market context and therefore it does not require an excessive proliferation of control units. However, a regulatory framework organized by objectives has the side-effect of a certain degree of multiplication of controls and can also lead to a lack of certain controls. Nevertheless, in this model, each intermediary is subject to the control of more than one authority, which might be more costly and moreover the administrative burden for financial intermediaries is significantly increased.

2 The Basel Committee for Banking Supervision, the International Organization of Securities Commissions (IOSCO) or the International Association of Insurance Supervisors (IAIS) can be named as examples at the international level.

3 Regarding the literature on financial regulation, I refer to Arestis and Basu (2003). Moreover, I suggest reading Barth, Caprio and Levine (2001).
The functional supervisory model postulates a given financial system that is considered to perform the following basic functions: (i) provision of ways of clearing and settling payments in order to facilitate trade; (ii) provision of a mechanism for the pooling of resources and for portfolio diversification; (iii) provision of ways of transferring economic resources through time, across borders, and among industries; (iv) provision of ways of managing risks; (v) provision of price information in order to help the coordination of decentralized decision making in the various sectors of the economy and (vi) provision of ways of dealing with the incentive problems created when one party in transaction has information that the other party does not have or when one party acts as agent for another.

Each type of financial services is regulated by a given authority independently of the operator who offers it. Therefore, the advantage of this approach is that it requires the same rules being applied to intermediaries performing the same activity of financial intermediation despite the operators may fall into different categories from a legal point of view. This approach fosters economies of specialization within supervisory authorities and represents an attractive solution for the regulation of integrated, advanced financial markets. Nevertheless, it includes the risk of an excessive division of competencies among regulatory agencies.

The often stressed single-regulator supervisory approach is based on a single control authority that is separated from the central bank being responsible for all markets and intermediaries, no matter if they are located in the banking, financial or insurance sector. Therefore this single authority has to deal with all objectives of regulation and – in the words of Abrams and Taylor (2000) – has to have the structure of the regulatory system needs to reflect the structure of the markets that are regulated. It is interesting to note that this model – after being first developed in Scandinavia around a decade ago – was introduced in the United Kingdom with the establishment of the Financial Services Authority (FSA) by merging part of the Central Bank staff, the Securities Investment Board, the directorship of the Department of Trade and Industry competent in the insurance field and the Security Regulatory Organizations, in order to make the organization of regulatory activities more efficient by reducing the costs of the regulation itself. The obvious advantages are the economies of scale by reducing the fixed costs as well as the logical expenses, the costs of administrative personnel and the compensation for the top management.

However, the effectiveness of this approach primarily depends on its high degree of internal organization. Nevertheless, the idea of a single supervisor is doubted by many commentators and policy-makers. A good representative having doubts is Lastra by stating that the creation of such a centralized authority at the supranational level has to be critically seen on the grounds of excessive concentration of power and lack of accountability and furthermore that there seems to be no empirical evidence that justifies the superior wisdom of any given model of organizing financial supervision (Lastra 2003: 52–53).

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4 For further details, I suggest reading Merton and Bodie (1995).
5 In this context I refer to Oldfield and Santomero (1997) and highly recommend the paper by Padoa Schioppa (1999).
6 It has to be kept in mind that the establishment of a single supervisory authority is a regulatory response to the rise in financial conglomerates and complex financial groups. In literature, this so-called single-regulator supervisory approach is supported by various arguments. One main argument – from an institutional point of view – is that the number of people employed by a single authority is likely to be lower than the added staff numbers of multiple supervisory authorities. Regarding a useful comparison of an integrated financial supervisor versus a specialist supervisor, I refer to Lannoo (2002).
Considerations Regarding an Optimal Model for Supervision in Europe

3.1 What Model Should Be Chosen?

As the short overview of the various regulatory models made it clear, it is difficult to find the optimal supervisory arrangement. However, as reality shows, none of the mentioned theoretical models exists without some nuances meaning borrowing some elements from other models. However, after shortly elaborating on the various shortcomings of each of the introduced models, I will in the following discuss the current regulatory arrangements in Europe, the impacts of the so-called Lamfalussy architecture as well as various suggestions from literature and then try to propose a new mixed approach for financial regulation and supervision in Europe.

3.2 The Ongoing Integration Among Intermediaries, Markets and Instruments

In Europe, the boundaries separating banking, securities and insurance segments are becoming increasingly integrated, which leads to a de-specialization of financial intermediaries. Therefore, the traditional tripartite division is not appropriate anymore, so that a unitary view of financial intermediation and regulation should be adopted. This can just be underlined when considering that the role of traditional banks is significantly challenged by the advances of information technology and the thereby caused entry of new players in the financial segments. Going along with technological challenges, the European financial market liberalization also led to a significant restructuring of the banking sector. One result of this financial market liberalization is that financial conglomerates become more and more important and thereby act rather on an international or supranational than on a national level. Moreover, insurance companies play a role of increasing importance as financial intermediaries. Therefore it is not surprising that considerable integration between banking and insurance markets as well as securities markets have taken place.

3.3 Various Regulatory Models in Europe

The gradual integration of European financial markets and in particular the evolution of the supranational legal framework significantly affected financial market regulation in each country. Originally, general regulation was focused on banking intermediaries according to their traditional role within the financial sector. The pressure of EC directives and the increasing cross-border financial market integration led to a situation, in which a combination of different regulatory approaches – despite the predominant existence of the traditional institutional model exists – emerged. Table 1 gives an overview of the current structure of supervision in Europe:

As Table 1 shows, there is a great number of integrated financial market regulators and supervisors in Europe, which have not too long ago been established, starting in Norway, Denmark, Sweden, the United Kingdom, Germany and Austria. In particular the Scandinavian countries were outliers regarding the establishment of integrated financial supervisors by establishing the Norwegian Kredittilsynet in 1986, Denmark’s Finanstilsynet in 1988 or Sweden’s Finanzinspektionen in 1991. Regarding the international spectrum it

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7 See Grünbichler and Darlap (2004).
has to be mentioned that Singapore with the establishment of the predominant and powerful Monetary Authority of Singapore (MAS) in 1984 and Canada with the foundation of the Office of the Superintendent of Financial Institutions (OSFI) were the first countries setting up integrated supervisory institutions. At the end of the 1990ies and the beginning of the new century a wave of newly established financial market regulators and supervisors significantly changed the institutional framework: the Australian Prudential Regulation Authority (APRA), the Financial Supervisory Service of South Korea and Fjármálaesfirlit in Iceland in 1999 were followed by the Hungarian Financial Supervisory Authority (HFSA) in 2000, the Finance and Capital Market Commission (FMC) of Latvia in 2001, the Austrian Finanzmarktaufsicht (FMA), Germany’s Bundesamt für Finanz-

### Table 1
The Regulatory and Supervisory Landscape in Europe

<table>
<thead>
<tr>
<th>Country</th>
<th>Banking</th>
<th>Securities</th>
<th>Insurance</th>
<th>Central Bank Involved</th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria</td>
<td>IS</td>
<td>IS</td>
<td>IS</td>
<td>Y</td>
</tr>
<tr>
<td>Belgium</td>
<td>IS</td>
<td>IS</td>
<td>IS</td>
<td>Y</td>
</tr>
<tr>
<td>Cyprus</td>
<td>CB</td>
<td>SeS</td>
<td>GA</td>
<td>–</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>CB</td>
<td>SeS</td>
<td>InS</td>
<td>Y</td>
</tr>
<tr>
<td>Denmark</td>
<td>IS</td>
<td>IS</td>
<td>IS</td>
<td>N</td>
</tr>
<tr>
<td>Finland</td>
<td>BaS/SeS</td>
<td>BaS/SeS</td>
<td>InS</td>
<td>Y</td>
</tr>
<tr>
<td>France</td>
<td>BaS/CB</td>
<td>SeS</td>
<td>InS</td>
<td>Y</td>
</tr>
<tr>
<td>Germany</td>
<td>IS</td>
<td>IS</td>
<td>IS</td>
<td>Y</td>
</tr>
<tr>
<td>Greece</td>
<td>CB</td>
<td>SeS</td>
<td>InS</td>
<td>Y</td>
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<tr>
<td>Hungary</td>
<td>IS</td>
<td>IS</td>
<td>IS</td>
<td>Y</td>
</tr>
<tr>
<td>Ireland</td>
<td>CB</td>
<td>CB</td>
<td>CB</td>
<td>Y</td>
</tr>
<tr>
<td>Italy</td>
<td>CB</td>
<td>SeS</td>
<td>InS</td>
<td>Y</td>
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<tr>
<td>Latvia</td>
<td>IS</td>
<td>IS</td>
<td>IS</td>
<td>N</td>
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<tr>
<td>Liechtenstein</td>
<td>IS</td>
<td>IS</td>
<td>IS</td>
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<tr>
<td>Lithuania</td>
<td>CB</td>
<td>SeS</td>
<td>InS</td>
<td>Y</td>
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<tr>
<td>Luxembourg</td>
<td>BaS/SeS</td>
<td>BaS/SeS</td>
<td>InS</td>
<td>N</td>
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<tr>
<td>Malta</td>
<td>IS</td>
<td>IS</td>
<td>IS</td>
<td>N</td>
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<tr>
<td>Netherlands</td>
<td>IS</td>
<td>IS</td>
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<td>Y</td>
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<tr>
<td>Norway</td>
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<td>–</td>
</tr>
<tr>
<td>Poland</td>
<td>CB</td>
<td>SeS</td>
<td>InS</td>
<td>Y</td>
</tr>
<tr>
<td>Portugal</td>
<td>CB</td>
<td>SeS</td>
<td>InS</td>
<td>Y</td>
</tr>
<tr>
<td>Slovenia</td>
<td>CB</td>
<td>SeS</td>
<td>GA</td>
<td>Y</td>
</tr>
<tr>
<td>Spain</td>
<td>CB</td>
<td>SeS</td>
<td>InS</td>
<td>Y</td>
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<tr>
<td>Sweden</td>
<td>IS</td>
<td>IS</td>
<td>IS</td>
<td>Y</td>
</tr>
<tr>
<td>Switzerland</td>
<td>BaS/SeS</td>
<td>BaS/SeS</td>
<td>InS</td>
<td>–</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>IS</td>
<td>IS</td>
<td>IS</td>
<td>Y</td>
</tr>
</tbody>
</table>

IS = Integrated Supervisor; CB = Central Bank; BaS = Banking Supervisor; SeS = Securities Supervisor; InS = Insurance Supervisor; Y = Yes; N = No.

3.4 The Supranational Level

At the supranational level, the European supervisory system became more and more integrated which can be described as a process from originally autonomous supervisors towards an intensive coordination of financial supervisors and maybe in the end full integration of European financial supervision. Full integration of all supervisory and regulatory powers within one institution is definitely the extreme end of this process and there are legitimate doubts that this might not be beneficiary for the financial regulatory and supervisory framework in Europe.⁸

However, the 2000 EU Council of Lisbon firstly formulated the clear political will to become the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion (Lisbon European Council 2000). Furthermore, the European Commission – with the support of the Financial Services Policy Group (FSPG) that is now replaced by the so-called Financial Services Committee (FSC) – proposed a so-called Financial Sector Action Plan, comprising around forty measurements in order to improve the joint legal and regulatory framework for enterprises being active in the European Economic Area. These measurements caused far-reaching changes to the existing framework and in order to efficiently implement these new rules, the already existing regulatory and supervisory committees were restructured to set up a structure being able to reach fast decisions of high legislative and technical quality on future regulation by – at the same time – having the support of the European Parliament (Randzio-Plath 2003).

The Committee of Wise Men on the Regulation of European Securities Markets, chaired by Mr. Alexandré Lamfalussy can be considered as the starting point for the in 2002 regarding the securities regulation and in 2003 regarding the banking and insurance sectors implemented four-tier system. This so-called Lamfalussy architecture, which was necessary after the recognition that the prevailing legislative and regulatory arrangement displayed some major weaknesses, can be characterized as follows (see Figure 1).

As the figure shows, the framework directives are coordinated by the Council and the Parliament on level I, which consists of the so-called “core” or political principles. The Council and the Parliament themselves have been advised by coordinated opinions of the EU regulators – such as the Ministries of Finance and other regulatory institutions at the national level – on level II as well as the supervisors, being the respective supervisory authorities on level III. Anyhow, the decisions regarding the implementing techniques and the adjustments of these techniques to the changing requirements are made on level II. Then, the regulators will implement the mentioned framework directives into national law.

⁸ Among the vast literature on this topic, I refer to Lastra (2003), Lannoo (2002) and Ingves (2004).
by making use of the various built-in choices in order to accommodate them to the specific national circumstances. It is worth mentioning that in order to avoid a kind of regulatory or supervisory arbitrage across national jurisdictions the regulators have to coordinate themselves in the so-called level III committees. Moreover, level IV constitutes a control-loop of the European Commission to safeguard the correct implementation of the directives, which means that adequate resources are devoted to enforcement on this level.9

3.5 What About National Regulation?

The previous description of the recent evolution in European financial markets and in particular the characterization of the Lamfalussy architecture have made it clear that any sug-

9 It is worth mentioning that this architecture is still in its early stages of implementation. This means that most notably level III and IV have hardly been tested, despite the framework legislation being level I is in place and the level II regulations are fairly good advanced. However, there are still serious concerns that the regulatory process itself remains fairly slow and that in particular too many implementation details kind of slip back from level II to level I as a result of lobbying efforts by market participants. Regarding more details on the Lamfalussy framework, I refer to EUROFI, The Four-Level Approach to Regulation and Supervision in Europe: Achievements, Concerns and Challenges.
gestion regarding a model for financial regulation and supervision in Europe has to fulfil an integrated, multi-task and multi-peak approach. Furthermore, the model has to be compatible with the Lamfalussy architecture itself since it can be considered most efficient, if the new supervisory body/bodies would be incorporated into this framework. However, this aspect just refers to the above mentioned supranational level, which is only one side of the coin. Therefore, it is necessary to shortly mention the importance of the national regulation because one has to keep in mind that the already existing national institutional setup constitutes the fundament of the following proposal because the national central banks as well as financial supervisors are the institutions executing the rules and directives of the supranational level and implementing them – in cooperation with the national governments – into national law.

4 A Proposal for a Model of Financial Regulation and Supervision in Europe

4.1 What About the U.S. Example?

After setting up a kind of framework of the European financial architecture and explaining its new developments, a proposal for an integrated regulatory approach is presented. This approach takes into account the already existing institutional settings as well as the Lamfalussy architecture. However, the starting point is again the various theoretical models as outlined above. As it should already be clear, none of the mentioned models can completely fulfil all criteria for an integrated regulatory approach. Therefore, the following approach tries to combine the necessity of financial stability in the Euro area with an integrated and coordinated supranational financial regulatory framework. This approach also tries to make the regulatory framework more transparent as well as to create clearer structures of the supervisory and regulatory framework within the Lamfalussy architecture. Therefore, the following proposal is intended to contribute to the ongoing discussion on European financial regulation in a constructive manner:

Basically, a so-called quasi-centralized financial regulation would be the ideal solution with regard to the already existing institutional settings as well as the Lamfalussy architecture. With quasi-centralized a framework similar to the U.S. financial architecture is meant. The U.S., being a single market as well as a single monetary area is characterized by a fragmented supervisory and a complex regulatory system influenced by both federal law10 as well as state law.11 In details, according to the U.S. model, banking is subject to both federal law as well as state law. Therefore, there are several supervisory authorities at the federal level, namely the Federal Reserve System, the Office of the Comptroller of the Currency as well as the Federal Deposit Insurance Corporation,12 as well as various supervisory institutions at the state level.

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10 According to U.S. federal law, financial laws have to be enacted by Congress.
11 Besides federal financial laws, state legislature is in particular relevant for the insurance branch.
12 Regarding a detailed analysis of the U.S. financial institutions as well as the federal banking law, I refer to Kammel (2005: 224–260). Anyhow, it is worth mentioning that the so-called Gramm-Leach-Bliley Act of 1999 had tremendous effects on commercial and investment banking in the U.S. One aspect of this Financial Services Modernization Act of 1999 was the expansion of activities permissible for affiliates of banks and thereby the creation of the so-called financial services holding companies (FSHC). FSHC are supervised by the Federal Reserve, whereas bank subsidiaries are supervised in a fairly complex manner by the Office of the Comptroller of the Currency, the Federal Reserve as well as by the respective state regulator. For further details on this, have a look at Broome and Markham (2001: 215–252).
Contrary to U.S. banking, the securities industry is characterized by regulation and supervision at the federal level as well as state law – based self-regulation. Institutionally, the Securities and Exchange Commission (SEC) at the federal level supervises the exchanges, such as the important New York Stock Exchange (NYSE), whereas the National Association of Securities Dealers (NASD) is empowered to set up – under the supervision of the SEC – rules for broker-dealers, such as the National Association of Securities Dealers Automated Quotation System (NASDAQ). Moreover, the U.S. insurance sector is – based on the McCarran-Ferguson Act of 1945 – a matter of state law, whereas pension funds are interestingly subject to federal law.

4.2 Legal Aspects and the Multiplicity of Committees

As the U.S. example shows, centralization is not strictly necessary in a single market with common monetary policy. This approach is indirectly reflected in Art. 5 EC, which states that

"[...], in areas which do not fall with its exclusive competence, the Community shall take action in accordance with the principle of subsidiarity, only if and insofar as the objectives of the proposal action cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale or effects of the proposed action, be better achieved by the Community."

Therefore, according to the Treaty, centralization is not the primary tool for financial regulation and supervision, which nevertheless does not exclude the possibility that some supervisory functions could eventually be transferred from the national to the supranational level. Since the Treaty does not focus on one supervisory model, various nuances of centralization in the sense of an organizing principle for the future European architecture can be pointed out: (i) centralization in the sense of a “single supervisor”, (ii) centralization understood as a model of “multiple supervisors” or (iii) centralization of just some supervisory functions, such as the macroeconomic important “lender of last resort”, whereas other supervisory functions remain at the domestic level.

There seems to be evidence that despite the implementation of the Lamfalussy architecture and the dominant role of the European System of Central Banks (ESCB), from an institutional point of view it is too early to set up one or multiple (kind of centralized) financial supervisors at the supranational level. This can simply be underlined by the fact that there still remain too many different national legal frameworks, supervising “traditions” and in particular not enough cooperation among the already existing institutions.

13 For further details on the U.S securities regulation I refer to the Securities Act of 1933 as well as Jackson and Symons (1999: 751–755). It is important to note that the newly introduced Sarbanes-Oxley Act of 2002 does not have a big impact on the institutional regulatory framework regarding U.S. securities markets because investment companies are – according to the Investment Company Act of 1940 and the Investment Advisers Act of 1940 – predominantly regulated by the SEC.

14 This was introduced by the Employee Retirement Income Security Act of 1974.

15 This is the Treaty of the European Communities, which strictly has to be distinguished from the Treaty of the European Union. Regarding the consolidated text versions of the most important European treaties, I refer to http://europa.eu.int/eur-lex/lex/en/treaties/index.htm

16 Lastra (2003) gives a nice overview of the several possible routes of centralization.
Nevertheless, one can observe that there is a significant trend towards cooperation and consolidation of supervisory institutions at the national level. Therefore, as a kind of coincidence to this development, numerous committees\textsuperscript{17} have been established at the supranational level. However, the financial architecture still remains pretty fragmented by specialized and to a minor degree cooperating financial institutions. Anyhow, these developments are at least a strong indicator that there is an ongoing integration, harmonization and cooperation process regarding financial supervisory institutions at the supranational level. The continuation of this process by gradually fostering the cooperation among the already established committees can be considered as to be very useful. An inflationary creation of new committees which might lead to the multiplicity of supervisory bodies and thereby a confusing and overlapping supervisory landscape would clearly lead to bureaucratic inefficiency and is therefore not recommended. The avoidance of bureaucratic inefficiency as well as the greater efficiency and effectiveness of the supranational institutional landscape and therefore the decision-making process is of general concern nowadays\textsuperscript{18}. When considering the efficiency of the supranational institutional landscape as the main criterion for the future European financial architecture, one has to keep in mind that this institutional framework of financial supervision in Europe has to be able to cope with the needs and the complexity of the enlarged EU. Since there is already over the last couple of years the ongoing discussion\textsuperscript{19} on the institutional reform of the EU, it might be a good idea to create an institutional framework of financial supervision, which is already capable to guarantee an efficient functioning even in the case of further new members in a few years\textsuperscript{20}.

4.3 A Proposal for the Institution Framework

Based on the so-called Lamfalussy architecture, I now present a possible future institutional framework of financial supervision, which (i) is based on the already existing committee setup and therefore just needs the creation of one additional committee, (ii) is characterized by a high degree of flexibility, (iii) is due to the fact that currently only one new institutional body would have to be established cost efficient and (iv) can be transformed into a centralized supervisory body, if the necessary environment in favour of such a development is created and the future financial infrastructure makes is necessary to proceed with this idea (see Figure 2).

As the figure shows, my proposed institutional framework is clearly based on the Lamfalussy architecture and is furthermore characterized by a clear institutional hierarchy. The four already in the Lamfalussy architecture proposed committees being the European Banking Committee (EBC), the European Insurance Committee (EIC), the European Securities Committee (ESC) and the European Financial Conglomerates Committee (EPCC) are responsible for their respective specialized areas and are themselves coordinated by a

\textsuperscript{17} In this context refer e.g. to the proposed and partly established committees in connection with the Lamfalussy framework, such as the European Securities Committee, the Committee of European Securities Regulators, the Reformed Banking Advisory Committee, the New Financial Conglomerates Committee or the Banking Committee.

\textsuperscript{18} See e.g. McDowell (2005). Regarding the text of the European Constitution, I refer to http://europa.eu.int/constitution/index_en.htm

\textsuperscript{19} See e.g. Enderlein, Lindner, Calvo-Gonzalez and Ritter (2005) or Dukes (2005).

\textsuperscript{20} Just keep in mind that already in 2007 Bulgaria and Romania are supposed to join the EU.
newly to establish so-called European Financial Coordination Committee. The main tasks of this committee are the coordination of the activities of the four other committees in particular regarding interdisciplinary and supranational tasks, the harmonization of the legal framework regarding European banking, securities and insurance markets as well as the information exchange and mutual advice with the European Central Bank (ECB). The advantage of this proposed institutional framework is that it is flexible regarding the state of integration across sectors and borders in Europe. In other words, this proposed institutional setting – especially through the newly to establish European Financial Coordination Committee – is currently designed to reflect the existing financial supervision being rather anchored at the national level with a gradually increasing degree of integration and transformation to the supranational level.

In case the EU reaches a significant high level of integration regarding the various financial sectors, this proposal makes it then possible that the supervisory structures in Europe can be adapted towards a – maybe then useful – single European supervisory authority. In such a case, the proposed institutional framework could be rearranged as follows:

Figure 3
Flexibility of the Institutional Framework

Source: Own creation.
As the figure shows, the institutional hierarchy has changed in that the former European Financial Supervisory Authority has incorporated all five above mentioned committees within one institution. Therefore, the numerous national financial supervisors are directly subordinated to the European Financial Supervisory Authority (EFSA). This structure can be compared with the role of the ECB within the ESCB.21 The EFSA and the ECB are closely collaborating and cooperating in the fields of financial supervision and regulation. However, it is obvious that the duties of the ECB within the ESCB duties are primarily the single monetary policy, the provision of macroeconomic stability, the handling of the Euro and thereby accomplishing price stability, whereas the EFSA solely focuses on financial supervision and regulation. Nevertheless, in my view there is the need that these two predominant and influential financial institutions in Europe are collaborating with and supporting each other in cases of supranational interest.

The clear advantage of this proposal is that due to the flexibility of the institutional framework regarding the state of integration across sectors and borders, no negative effects on the macroeconomic as well as microeconomic stability can be expected because this danger will be fielded and suspended by the institutional setup. Furthermore, well functioning and flexible supervisory institutions is able to enforce and guarantee market transparency as well as keep a high level of investor protection. Moreover, market transparency as well as macro- and microeconomic stability provide a favourable environment and framework for competition in the financial intermediation sector.

5 Concluding Remarks

This paper tried to give an overview of the sustainable developments within the European financial architecture and is intended to contribute to the ongoing discussion regarding the future appearance of the financial supervisory framework in Europe. As argued above there is evidence that it is too early to establish a single European supervisory authority. Therefore, it might be useful to make use of the gradually implemented Lamfalussy architecture and simply add one more committee being the so-called European Financial Coordination Committee which has the task to coordinate the activities of the four within the Lamfalussy architecture proposed committees in particular regarding interdisciplinary and supranational tasks, the harmonization of the legal framework regarding European banking, securities and insurance markets as well as information exchange and mutual advice and cooperation with the ECB. The institutional design of this committee is quasi-centralized, meaning that it partly fulfils tasks of a single central supervisor but that – from an institutional and in particular legal point of view – it is no supranational authority on its own. The advantages of this proposal are that it just needs the creation of one additional committee, its institutional framework is characterized by a high degree of flexibility, moreover that it is cost-efficient since it is based on partly already existing structures and that its institutional arrangements can be transformed into a centralized supervisory authority.

21 For further details on the ESCB as well as the role of national central banks within the ESCB, I refer to Wel- link, Chapple and Maier (2002) and Wynne (1999).
References

