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C(2009) 8014

Dear Lord Roper,

Thank you for sending us your Report on the Future of EU financial regulation and supervision {COM(2009)252}.

In line with the Commission's decision to encourage National Parliaments to react to its proposals to improve the process of policy formulation, we welcome this opportunity to respond to your comments. I enclose the Commission's reply and hope you will find this a valuable contribution to your own deliberations.

I look forward to developing our policy dialogue further in the future.

Yours sincerely,

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EUROPEAN COMMISSION

Brussels, September 2009

COMMENTS OF THE EUROPEAN COMMISSION ON THE REPORT OF THE HOUSE OF LORDS ON THE FUTURE OF THE EU FINANCIAL REGULATION AND SUPERVISION {COM(2009)252}

The Commission welcomes this Report on the Future of EU Financial regulation and supervision which is intended to contribute to an in-depth review of the current regulatory and supervisory regime ("the Report") and notes that the Report will now be made available for debate. We would also like to thank the Committee for the good cooperation which defined relations throughout the course of the inquiry.

The Commission has been and will continue to promote a common EU – and a global - response to the financial crisis. The EU's response to the global economic crisis has been a test of resilience and of speed of reaction. This situation has also presented challenges of co-ordination and reinforced the need for solidarity among the 27 Member States. The Commission and Member States have responded positively to the need to take measures to deal with the crisis and prepare for recovery.

The Report considers the reform of regulation and supervision in the light of the financial crisis and the Commission's response as of the date of publication of the Report (9th June) including the following proposals adopted by the Commission namely changes to the capital requirements regime, deposit guarantee schemes, credit rating agencies and alternative investment funds.

However, the Report was completed before the Commission's further proposals in this area could be assessed by the Committee. These proposals are set out in the Commission's 27 May Communication 'European Financial Supervision'[1] and further details are given below. Some of the issues raised by the Committee are addressed therein.

As the Commission also stated in its response to the Committee in December 2008 on another of its reports, "A Single Market for 21st Century Europe", the Commission has made considerable efforts to effectively address the financial crisis. The Commission's strategy involves short term measures, to calm and restore market confidence, as well as medium term measures, aiming at strengthening the resilience of the EU financial system. The latter include the Commission amendments to the Capital Requirements and the Deposit Guarantee Schemes Directives, the proposed regulation on credit rating agencies and the proposal on

[1] http://ec.europa.eu/internal_market/finances/committees/index_en.htm#communication

alternative investment funds. The Commission also envisages long term measures as part of its strategy over the remainder of 2009 and beyond.

The Commission will continue to implement the ambitious reform of the European financial system which is set out in the Commission's 4 March Communication *Driving European Recovery*[2], taking account of the views from all stakeholders. The reform will set a clear course for the EU to lead and shape the process of global change in particular through the work of the G-20.

We intend to provide the EU with a supervisory framework that detects potential risks early, deals with them effectively before they have an impact and meets the challenge of complex international financial markets.

The financial supervision package outlined in the Commission's 27 May Communication 'European Financial Supervision' comprised of:

- a European Systemic Risk Board (ESRB) which should monitor and assess risks to the stability of the financial system as a whole. It will provide early warning of systemic risks that may be building up and, where necessary, recommendations for action to deal with these risks. The creation of the board would address one of the fundamental weaknesses highlighted by this crisis, which is the exposure of the financial system to interconnected, complex, sectoral and cross-sectoral systemic risks; and.
- a European System of Financial Supervisors (ESFS) for the supervision of individual financial institutions, consisting of a network of national financial supervisors working with new European Supervisory Authorities. The ESFS will combine nationally-based supervision of firms with specific tasks at the European level. It aims to foster harmonised rules and coherent supervisory practice and enforcement. This network should be based on the principles of partnership, flexibility and subsidiarity and should work to enhance trust between national supervisors by ensuring, for example, that host supervisors have an appropriate say in setting financial stability and investor protection policies so that cross-border risks can be addressed more effectively.

Following the broad endorsement given by the June European Council to this proposed new supervisory architecture, the Commission will present the necessary detailed legislative proposals in early autumn. We note the Committee's support for the establishment of a new body at EU level to assess and monitor macro-prudential systemic risk arising from financial markets and institutions.

We note also your concerns in a number of areas, and will ensure that our proposals take into account the views of all stakeholders and institutions. In particular, the conferral of competences will be in full conformity with the Treaty. Without prejudice to the application of Community law, and recognising the potential liabilities that may be involved for Member States, our proposals will also ensure, in line with the June European Council conclusions, that decisions under the above mechanisms should not impinge on the fiscal responsibilities of the Member States. Moreover, any decision by the European Supervisory Authorities or the Commission in this regard will be subject to review by the Community Courts. The

[2] http://ec.europa.eu/commission_barroso/president/pdf/press_20090304_en.pdf

implementation of these arrangements will have to be monitored, and their effectiveness carefully assessed. We propose that the system should be reviewed within three years.

We have taken careful note of the doubts and concerns the Committee has signalled in relation to alternative investment funds. The latter has the objective to create a comprehensive and effective regulatory and supervisory framework for AIFMs at the European level. The proposed Directive will provide robust and harmonised regulatory standards for all AIFM within scope and will enhance the transparency of the activities of AIFM and the funds they manage towards investors and public authorities.

We consider that the proposal is proportionate in the requirements imposed, which differentiate between different instruments according to the level of risk they pose. It takes into account the ongoing work at global level to tackle the issue of off-shore centres, whilst avoiding closing the door to funds and service providers located outside the EU. Finally, the proposal opens new internal market opportunities for industry through the new passport, whilst ensuring that investors are properly protected. The proposal is now the subject of political discussion between the Parliament and the Council and in that context many of the issues the Committee has raised are being examined carefully.

Our programme also aims to fill gaps where European or national regulation is insufficient or incomplete, based on a 'safety first' approach. For example, we also published in July a consultation on the safety of derivatives markets.[3] We are also planning further significant prudential changes in the banking sector. On 13 July, we presented proposals to amend the Capital Requirements Directive to increase capital charges for the trading book in line with the Basel process and to ensure that banks take due account of the risks associated with resecuritisation and remuneration policies. In October we will present further proposals to introduce dynamic provisioning for banks and to address leverage and liquidity concerns. We are consulting[4] on a number of these potential changes at the present time and welcome your views. We also intend to issue a Communication in October on the EU's cross border crisis management framework which requires significant upgrading.

A stable and sound financial sector is a prerequisite for building a sustainable recovery. Last autumn, coordinated European action to increase access to liquidity in the system, recapitalise and provide guarantees for banks liabilities across the EU prevented the meltdown of the European banking industry and helped restore liquidity in interbank markets. We must continue to ensure that these support packages are effectively implemented to secure financial stability and at the same time, they minimise distortions to competition. In parallel, the Commission will continue to apply the framework for urgent rescue relief as well as long-term restoration of viability in application of the existing state aid guidance. In this context, we welcome the Committee's supportive comments on the issue of state aid control.

Finally, we must also ensure that European investors, consumers and SMEs can be confident about their savings, access to credit and their rights as concerns financial products. We recently published a Communication on retail investment products[5], a consultation on

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[3] http://ec.europa.eu/internal_market/financial-markets/derivatives/index_en.htm#consultation

[4] http://ec.europa.eu/internal_market/consultations/2009/capital_requirements_directive_en.htm

[5] http://ec.europa.eu/internal_market/finservices-retail/investment_products_en.htm

responsible borrowing and lending in the EU[6] and will soon review the adequacy of existing deposit guarantee schemes and make appropriate legislative proposals including in some of the areas where the Committee has signalled ongoing problems. We also want to strengthen consumer and user views in our policy making process.

We are committed to working with all concerned to build a stronger, more reliable financial system for the future. We welcome your continued views and contributions to the debate around how to ensure this.

[6] http://ec.europa.eu/internal_market/consultations/docs/2009/responsible_lending/consultation_en.pdf