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EUROPEAN COMMISSION'S GREEN PAPER ON FINANCIAL SERVICES POLICY (2005-2010)

EUROSYSTEM CONTRIBUTION TO THE PUBLIC CONSULTATION

INTRODUCTION

As a contribution to the definition of the Commission's main priorities for financial services policy, the European Central Bank (ECB) would like to provide its remarks on the Green Paper on Financial Services Policy 2005-2010 (COM (2005) 177) (henceforth "Green Paper"). These remarks reflect the views of the Eurosystem, which comprises the ECB and the national central banks (NCBs) of the countries that have adopted the euro. The remarks are organised and presented as follows: Section 1 briefly highlights the Eurosystem's interest in the pursuit of financial integration. Section 2 refers to the key political orientations of the Green Paper. Sections 3, 4 and 5 provide specific comments on the fields of financial regulation, financial supervision and financial stability arrangements respectively. Section 6 draws some conclusions.

1. THE EUROSYSTEM'S INTEREST

The objective of furthering financial integration across Member States is at the core of the EU financial services policy. This objective is also in line with the main target of the Lisbon Agenda, which is to render the EU a more competitive and dynamic knowledge-based economy. Financial integration is generally accepted to be a key factor in the development and modernisation of the financial system which, in turn, leads to greater productivity and competitiveness, a more efficient allocation of capital and potential for increased non-inflationary economic growth. In this respect, it should be noted that other factors, such as legal initiatives that influence the ability to innovate, transparency, the production and dissemination of information as well as the enforcement of, and adherence to financial contracts are also important for economic performance.

A well integrated financial system is of particular importance for the Eurosystem for three main reasons. First, the financial system is used for the conduct of the monetary policy in the euro area, which is the basic task assigned to the Eurosystem under the Treaty establishing the European Community (the "Treaty")¹. The smooth and effective transmission of monetary policy impulses throughout the euro area is enhanced through integrated and efficient financial markets. Second, it is important for the smooth

¹ In accordance with Articles 4(2), 105(1) and 105(2) of the Treaty establishing the European Community (the "Treaty"), the primary objective of the definition and conduct of the single monetary policy, which is a basic task of the Eurosystem, shall be to maintain price stability.

functioning of payment and clearing systems, which is another basic task of the Eurosystem under the Treaty. Integration of capital markets is a key condition for the efficient liquidity and collateral management, which is, in turn, a basic condition for the settlement of securities and payment transactions. Third, it is important for the interaction between the integration of financial systems and financial stability. The Eurosystem also has the task of contributing to financial stability in the euro area and the EU.² The pursuit of financial integration can have very beneficial effects on financial stability as more integrated financial markets could provide the necessary conditions for the smoother absorption of financial shocks. It may also help financial institutions to better manage and diversify their risks and realise economies of scale, which may, in turn, lead to greater efficiency. At the same time, it is necessary to monitor more closely the challenges of financial integration for financial stability which may stem from contagion through intensified cross-border links (for instance, via market infrastructure, interbank exposures, shareholdings and participating interests). Moral hazard may also increase if larger institutions pose a higher risk to the system in the event of a failure. The interaction between financial integration and financial stability therefore deserves continuous attention. In this context, these remarks also pay particular regard to the financial stability dimension of financial services policy.

2. KEY ORIENTATIONS OF THE GREEN PAPER

The Eurosystem would like to express its broad support for the key political orientation of the Green Paper which also reflects, to a certain extent, the ECB's earlier contributions to the debate on the matter. Over the next five years, financial services policy should aim primarily to consolidate and simplify existing Community legislation, while ensuring the effective and consistent implementation and enforcement at the national level of the measures adopted thus far under the Financial Services Action Plan (FSAP). To this end, the Lamfalussy approach – originally devised for the securities sector and subsequently extended to banking and insurance – should be exploited to the greatest extent possible. The Eurosystem also welcomes the emphasis on the need to enhance synergies among different public policies (financial services, competition, consumer protection) in order to support financial integration.

The Eurosystem agrees with the outline of the *specific priority areas* identified in the Green Paper, notably the pursuit of better regulation, the consolidation of financial services legislation, the completion of remaining measures, the pursuit of efficient and effective supervision, the removal of remaining obstacles to cross-border finance and the external dimension. In this respect, the Eurosystem would single out the following aspects:

- the proposed “*better regulation*” approach, based on openness and transparency in policy-making as well as targeted and evidence-based initiatives, is fully accepted by the Eurosystem. This approach should encompass existing as well as future legislation. New Community legislative initiatives –

² Article 105(5) of the Treaty sets out the statutory tasks of the Eurosystem to contribute to the smooth conduct of policies pursued by the competent EU and national authorities on the prudential supervision of credit institutions and the stability of the financial system.

although they should not be pre-empted a priori – should be assessed on a case-by-case basis, both ex-ante and ex-post. In this regard, the Eurosystem welcomes the Commission’s commitment to continue working on the preparatory phase of new initiatives through open dialogue with all stakeholders, including the Eurosystem;

- the Lamfalussy arrangements are a key element in enhancing *supervisory cooperation at the EU level* in terms of reducing compliance costs for financial institutions, thus favouring financial integration. However, it is also important to ensure that supervisory action is still effective once increased financial integration has been realised. The Eurosystem is confident that the Level 3 committees will be able to deliver successfully in this area;
- as regards the completion of outstanding measures, the Eurosystem would prioritise those favouring further integration of *financial market infrastructures*. As mentioned in the Green Paper, a clear public policy orientation for the five-year time horizon should be elaborated in order to remove impediments to the consolidation of market infrastructures.

Furthermore, the Eurosystem would like to convey the following considerations on issues that are only touched upon or not explicitly mentioned in the Green Paper.

First, given the further progress expected in the degree of EU financial integration, continued refinement of the *arrangements for safeguarding financial stability* is crucial. Significant progress has been achieved in this area over the past years, particularly as a result of the activities of the Economic and Financial Committee (EFC) as well as of the work of the Eurosystem with the support of the ESCB Banking Supervision Committee (BSC). In this context, possible additional measures for preserving financial stability at the EU level should remain on the radar screen of public authorities as a priority for financial services policy.

Second, the pursuit of further financial integration cannot only rely on public action; it also presupposes the *initiative of market participants* to exploit the opportunities arising from the removal of obstacles by public authorities by expanding their cross-border activities. In this context, the ECB has repeatedly noted that public authorities could serve as catalysts for coordination among market participants, thus facilitating the emergence of market-led initiatives that foster financial integration.³ In addition, a greater role for the private sector through self-regulation might be instrumental in this process, in particular through promoting the convergence of market practices.

Third, as experienced with the FSAP, the success of any plan is also dependent on the effectiveness of the *monitoring of its implementation*. Therefore, the Commission should consider effective ways of monitoring the implementation of the financial services policy in the medium term.

³ In the central banking sphere, examples of cooperation between the private sector and central banks are the Short-Term European Paper (STEP) initiative and the launch of the Single Euro Payments Area (SEPA).

3. FINANCIAL REGULATION

In the field of financial regulation, the general approach proposed in the Green Paper aims to foster “better regulation” and consistent application and enforcement of Community legislation at the national level. More specifically, the Green Paper identifies the priorities as being the simplification and consolidation of all relevant (European and national) financial rules as well as supervisory convergence. The Eurosystem considers that these two priorities are interlinked. As already highlighted earlier,⁴ the ultimate objective – to be pursued through an effective implementation of the Lamfalussy approach – should be the development of a common set of technical requirements, to which market participants can directly refer in their cross-border activities and which would be interpreted and enforced consistently by Member States’ authorities. A more unified regulatory framework for integrated financial markets should also be able to quickly adapt to market developments.

The Eurosystem has the following observations on the main proposals of the Green Paper in the field of financial regulation.

(a) Financial services rulebook

The Green Paper proposes that efforts be made to simplify and consolidate the relevant European and national financial services rules which might, over time, be incorporated into a financial services rulebook. One particular suggestion by the Commission is to “*launch a feasibility study to find out if over time all rules (at European and also national level) can be fused in one body of consistent law*”. This process would include the identification of supplementary national layers (introduced at a certain point in time at the national level) that may need to be reassessed in the light of developments in financial markets and the importance of enhanced convergence (avoidance of “gold-plating”).⁵

The Eurosystem wishes, first, to note that the notion of the “financial services rulebook” is not fully elaborated in the Green Paper and thus can be understood in different ways. The Eurosystem understands this concept mainly as a tool to rationalise the existing set of rules for financial institutions which have been defined at the Community level with a view to reducing complexity and legal uncertainties and to eliminating possible inconsistencies. It should not be an instrument to introduce new Community legislation in the financial field or to fully harmonise national rulebooks. In addition, it is appropriate that the process of rationalisation of rules is pursued on a sectoral basis (banking, securities and insurance), in line with the way in which Community legislation has developed over time. Finally, given that an important component of the existing rules is associated with the national transposition of Community legislation, the rationalisation effort should be carried out by the Commission, in close cooperation with the Member States. Overall, the pursuit of a financial services rulebook, as set out above, has the potential to benefit financial institutions, especially those operating cross-border.

⁴ See the Eurosystem’s contribution to the public consultation on the Commission’s review of the application of the Lamfalussy framework to EU securities market legislation published on <http://www.ecb.int/pub/pub/prud/html/index.en.html>.

⁵ Defined in the Green Paper “as the additional layer of regulatory additions that go beyond the Directives themselves thus stifling the benefits of a single set of EU rules and adding unnecessary burden and cost to the EU financial industry.”

The Eurosystem is also of the view that an appropriate use of the main elements of the Lamfalussy approach (notably EU-wide framework principles laid down in Level 1 legislation, EU-wide technical provisions embodied in Level 2 measures and common enforcement practices by supervisory authorities) could help the rationalisation effort. In particular, the following aspects are worth mentioning:

- first, there may be some scope for *better distinguishing between Level 1 and Level 2 legislation*. While Level 1 should basically set out core principles, Level 2 should determine the technical details. At the same time, it is also acknowledged that politically important decisions should be taken at Level 1. As noted by the Inter-Institutional Monitoring Group, some of the Level 1 measures adopted so far still involve an excessive level of detail, leaving limited scope for Level 2 acts. The adopted Markets in Financial Instruments Directive (MiFID) and the forthcoming Capital Requirements Directive⁶ are examples where there is scope for improvement in terms of a better distinction between the two levels of legislation;
- second, the *Level 2 measures should represent the major part of the technical legislation at the EU level*. The use of Regulations for the adoption of Level 2 measures, whenever possible also in relation to the specific content of the draft legislative provisions, could speed up the rationalisation process since this form of legal act is directly applicable in Member States;
- third, effective *supervisory convergence would play an important role* in ensuring a consistent enforcement of financial services regulations across Member States by the national authorities. Since the interpretation of rules by national authorities and their subsequent application to individual cases are important components of national rulebooks, agreements on common approaches by Level 3 committees, and compliance with them, would help ensure consistent implementation across countries. Furthermore, with a view to supporting a consistent implementation of EU legislation and supervisory convergence, the supervisory disclosure of both national rules and supervisory practices in all financial sectors could enhance transparency and add clarity to commonalities and specificities of the regulatory framework in the Member States. It is recalled that the CEBS has recently published plans for such disclosures to be made in a unified format and on an internet location in order to meet the requirement of Article 144 of the forthcoming Capital Requirements Directive. The experience of the CEBS may serve as an example for the other Level 3 committees to develop similar initiatives.

Finally, the Eurosystem supports the Commission's intention to read through all the directives in the financial sector to ensure consistency and internal coherence of terminology and effect, with the ultimate aim of codifying them.

⁶ See, for instance, the ECB Opinion on the capital adequacy framework for credit institutions and investment firms (CON/2005/4) OJ C 52, 2.3.2005, p. 37, also available on <http://www.ecb.int/ecb/legal/1353/1330/html/index.en.html> (paragraphs 8-10).

(b) Ongoing and new legislative initiatives

Ongoing initiatives

The Eurosystem underlines the importance of the legislative initiatives that are under way at the EU level in the following areas.

Financial institutions and markets

First, the main legislative initiative affecting financial institutions remains the adoption of the Capital Requirements Directive (applying to both banks and investment firms) which will implement within the EU the essence of the revised capital framework agreed by the Basel Committee on Banking Supervision (the Revised Basel Framework). In this regard, the Eurosystem supports a timely and consistent adoption of the Directive.

Second, the Eurosystem welcomes the various initiatives undertaken by the Commission following the informal ECOFIN meeting in Scheveningen in September 2004 to identify existing obstacles to cross-border consolidation in the banking sector, including those described in the Green Paper (review of Article 16 of the Consolidated Banking Directive, the Commission's public consultation on obstacles to cross-border mergers and acquisitions in the financial sector). The Eurosystem also supports the Commission's intention to adopt a communication to indicate to national authorities and economic operators in Member States how the Commission interprets the provisions of Article 56 of the Treaty on capital movements and the right of establishment, notably on the basis of the case law of the European Court of Justice. This may help to clarify the legal environment in which the cross-border consolidation of the banking industry should take place, both enabling Member States to shape their policy and further enhancing financial integration.

Third, the importance of the implementing measures that are being prepared in the *securities field* (e.g. MiFID, Transparency Directive) is fully recognised and the ECB stands ready to provide its technical support through its participation in the competent Level 2 committee. At the technical level, the ECB also supports the work of the Commission in the field of *mortgage credit markets*.

Market infrastructure

First, the Commission's intention to consider a new legal framework for *payments* in the Internal Market is broadly supported. In this context, the Eurosystem sees value in aligning the regulatory aspects (licensing and supervision) of the new framework with the Community legislation on banking and the work on the review of the E-money Directive. Furthermore, to protect the public from being exposed to unnecessary risks, it is of utmost importance that payment institutions are subject to sufficient prudential rules while planned civil law rules should not unduly stifle progress in this area.

Second, the Eurosystem attributes high importance to *securities clearing and settlement* as an integral part of the EU financial services policy framework and supports in principle the Commission's commitment to consider securities clearing and settlement a priority for future action. The appropriate mechanisms for clearing and settlement should be considered as the basic infrastructure for executing financial transactions on a cost-effective and safe basis. In particular, the Eurosystem welcomes the Commission's plan to put forward a proposal for a directive on clearing and settlement that will address issues relating to comprehensive rights of access and choice, a common regulatory framework, and high-level principles for appropriate governance arrangements and supports the Commission's plan to prepare a regulatory impact assessment before deciding on a formal proposal for a clearing and settlement Directive. The removal of the existing barriers to efficient EU clearing and settlement arrangements, as identified by the "Giovannini Group", will require the combined efforts of the private and public sectors. A directive could complement the market-led elimination of these barriers, thus fostering effective competition in the field of clearing and settlement. At the current juncture, the work of the Commission's expert groups should be intensified and the results be waited for.

The Eurosystem's interest in securities clearing and settlement systems is four-fold. *First*, because of the size of the payments made through securities settlement systems, the latter could potentially affect the functioning of payment systems. Since, according to the Treaty, the Eurosystem is responsible for "promoting the smooth operation of payment systems", it has an interest to exercise its oversight of payment systems with regard to certain aspects of the securities infrastructure. *Second*, according to the Treaty, the Eurosystem may grant credit only against "adequate collateral". In this regard, the improper functioning of the securities infrastructure could seriously impact the ability of the Eurosystem to conduct monetary policy and to operate the TARGET system. *Third*, the soundness and efficiency of the securities infrastructure in the euro area is an important prerequisite for financial stability, for the confidence of the users and, ultimately, for confidence in the currency. *Finally*, some of the national central banks, which form an integral part of the Eurosystem, have explicit legal responsibilities in the field of securities clearing and settlement.

Third, the Eurosystem supports the Commission's proposal to prepare a legal assessment of the Hague Convention by end-2005. In its Opinion concerning the Hague Convention, the ECB advocated the "*need for a swift substantive book-entry securities law reform and harmonisation, which would enhance the integration of financial markets within the EU*".⁷ In this regard, due consideration should also be given to the draft UNIDROIT Convention on harmonised substantive rules regarding securities held with an intermediary, which confirms the Eurosystem's previously expressed concerns with regard to the Hague Convention.

⁷ The ECB also favoured such assessment in its Opinion of 17 March 2005 at the request of the Council of the European Union on a proposal for a Council decision concerning the signing of the Hague Convention on the Law applicable to certain rights in respect of securities held with an intermediary (COM(2003) 783 final) (CON/2005/7).

New initiatives

As regards new initiatives in the future, the Eurosystem supports the Green Paper's proposal that any new legislative intervention should be carefully assessed and subject to a regulatory impact analysis. At the same time, public sector action might be necessary in order to overcome remaining obstacles to financial integration. In this regard, the Eurosystem agrees that *asset management* and *retail financial services* are areas where regulatory intervention at the EU level could be considered. With regard to asset management, the issue as to whether or not a specific regulatory treatment of hedge funds is needed deserves attention. As far as retail financial services are concerned, the Eurosystem recognises that a combination of targeted regulatory actions and a more active application of competition policy could be the way forward. In particular, issues related to bank accounts deserve careful attention as they are the starting-point for the distribution of banking and financial services.

As to other areas for possible initiatives, the Eurosystem would like to propose EU legislation to harmonise the legal framework for taking bank loans as collateral for Eurosystem purposes and to ease the formal requirements relating to it. This is related to the recent decision of the Eurosystem to include bank loans in the Single List of Collateral for monetary policy operations.

(c) Future developments of the Lamfalussy framework

The Eurosystem notes that due consideration should be given to the future prospects of the Lamfalussy framework in terms of both the expiration of the "sunset" clause in 2007 and the recent developments concerning the European Constitution. In this regard, the Eurosystem supports the Commission's intention to start a dialogue with the Member States and the European Parliament to put in place the mechanisms needed to allow the Lamfalussy process to continue to play its role in facilitating and speeding up financial integration.

4. FINANCIAL SUPERVISION

The Eurosystem agrees with the *three-step evolutionary approach* (agreement on policy objectives, maximum use of current framework, development of new structures) envisaged by the Commission for addressing the framework for financial supervision in the EU. In particular, the Eurosystem fully supports the underlying overarching notion that the *current institutional set-up should be exploited as far as possible before considering any structural change*.

First, the Eurosystem agrees with the view that the main *policy objective* in the area of financial supervision in the medium term is *twofold*, notably: (i) to enhance the competitiveness of EU financial markets and institutions and to facilitate the development of cross-border finance in terms of both institutions and products/services (financial integration angle); and (ii) to ensure the effectiveness of standards for oversight and supervision in a more integrated financial system (financial stability angle).

Second, the Eurosystem, in general, endorses the idea that these policy objectives should be pursued by exploiting the potential inherent in the existing institutional framework, notably the Lamfalussy framework. This could be done primarily through *three strands of action*, including: (i) the removal of inconsistencies in Community legislation on the supervisory framework; (ii) greater clarity in the role and responsibilities of supervisors; and (iii) supervisory convergence. At the same time, any gaps in the other existing arrangements for financial stability (financial stability assessment, management of stress situations, deposit insurance) that are closely linked to financial supervision are being addressed.

In this regard, the Eurosystem makes the following additional observations on the supervisory issues:

First, owing to market developments, the *interaction between home and host supervisory authorities* is set to increase and this is also reflected in the regulatory framework. In the banking field, the forthcoming Capital Requirements Directive will enhance the role of the consolidating supervisor and require competent authorities to have written coordination and cooperation arrangements in place. In the financial conglomerates field, a competent authority is assigned responsibility for exercising supplementary supervision (the coordinator); coordination arrangements are also provided for. It is important that such forms of coordination are developed on a robust and consistent basis for the banking groups and financial groups involved. To this end, the CEBS's development of guidelines for coordination and cooperation to be used by all supervisory authorities concerned could help significantly. Moreover, such guidelines should take into account the involvement of central banks, given their role in financial stability and contribution to prudential supervision. Application of these new guidelines, notably on consolidated and supplementary supervision, should be monitored and assessed within a predefined timeline.

Second, the *supervision of the liquidity risk*. Following developments in financial markets (e.g. introduction of the euro, centralisation of liquidity management at financial institutions), there is a need to review in general the current regime for liquidity supervision. The Eurosystem fully supports the review planned by the Commission and intends to contribute to this work, given central banks' interest in liquidity issues.

Finally, the Eurosystem sees merit in defining specific final and intermediate objectives for enhancing the supervisory framework, as well as a precise time frame. This should also aim to provide a basis for regular assessments of the overall progress.

5. FINANCIAL STABILITY ARRANGEMENTS

There are two reasons why the refinement of financial stability arrangements should remain a key policy priority of public action at the EU level. First, as mentioned above, with greater financial integration in the EU, cross-border risks to financial stability need to be adequately monitored and mitigated and mechanisms put in place to effectively manage situations of financial stress with a cross-border

dimension. Second, as the Commission also highlighted, there should, in general, be consistency between the supervisory framework and other financial stability arrangements.

The framework for financial stability has recently been strengthened considerably on the initiative, among others, of the EFC and the Eurosystem. The Reports adopted by the EFC on financial stability and on financial crisis management⁸ believed the current institutional framework to be adequate but recommended a number of enhancements aimed at improving its practical functioning. Cooperation among authorities in the appropriate committees is the main tool for making such enhancements. For its part, the Eurosystem, with the support of the BSC, has set up a process to systematically monitor the potential vulnerabilities and degree of resilience of the financial system as a whole (institutions, markets and infrastructure) at the euro area/EU level. This assessment is reflected in the ECB's Financial Stability Review which is published twice a year and since December 2004 has been made available to the general public. It also complements the monitoring of financial stability, which is conducted at the national level by central banks and supervisory authorities.

There are *three* broad areas, notably financial stability assessment, management of financial stress and deposit insurance, in which the Eurosystem sees potential for enhancement.

(a) Financial stability assessment

Two main aspects need to be highlighted in this context. First, the monitoring of financial stability *at the domestic level*. Owing to the increasing volume of cross-border banking, monitoring the stability of domestic financial systems has become a more complex task since it is now more dependent on cross-border developments. There is thus a need for better cooperation and exchanges of information among the central banks and supervisory authorities involved. The Eurosystem, with the support of the BSC, is pursuing this objective. Second, the monitoring of *cross-sector risks*. The blurring of boundaries between financial sectors in terms of financial markets, institutions and instruments constitutes an additional challenge for the authorities responsible for financial stability. In the EU, this aspect is compounded by the cross-border dimension of risks. There is therefore a need for a comprehensive overview of cross-sector risk at the EU level. The financial stability monitoring process developed by the Eurosystem with the support of the BSC already adopts a cross-sector approach to financial stability, but its main focus is on risks of a cyclical nature. Consequently, there is room to improve the monitoring of cross-sector risks of a more *structural* nature (e.g. credit risk transfer, hedge funds) which could be achieved through better structured cooperation between the BSC and the Level 3 committees.

⁸ Economic and Financial Committee, 2000, "Report on Financial Stability", Economic Paper No 143 (Brouwer Report I); Economic and Financial Committee, 2001, "Report on Financial Crisis Management", Economic Paper No 156 (Brouwer Report II).

(b) Management of financial stress

Significant progress has recently been made in terms of the arrangements for managing financial stress at the EU level, again under the aegis of the EFC and the Eurosystem. This applies, in particular, to the *set-up for cooperation among the competent authorities* and mainly relates to the ex-ante *clarification of procedures* for the cooperation and exchange of information among the relevant authorities in situations of financial stress. To that end, the first memorandum of understanding (MoU) on cooperation in crisis management, prepared by the BSC, was adopted by the EU central banks and banking supervisory authorities in 2003. This MoU also involved the establishment of a specific infrastructure for communication, including a list of emergency contacts. In May 2005, a second MoU on cooperation in crisis situations was agreed by the EU central banks, banking supervisors and finance ministries.

Looking ahead, the Eurosystem sees the main priority in this area to be a *further specification* of the arrangements for effective cooperation among the relevant authorities. For instance, the BSC and the CEBS are currently jointly developing proposals for the further enhancement of cooperation between central banks and banking supervisors, particularly in terms of identifying best practices for handling financial crises at the cross-border level and building up operational mechanisms. This is also relevant in the context of giving effect to the proposal for Article 130 of the forthcoming Capital Requirements Directive on cooperation in an emergency situation. If adopted, this provision would warrant further specification at the level of supervisory and central banking practices relating to banking groups. In this context, the usefulness of conducting periodic *simulation exercises* as a tool for developing preparedness and identifying possible sources of coordination failures should be underlined.

The provision of *emergency liquidity assistance* (ELA) by central banks to individual institutions experiencing liquidity strains is mentioned in the Green Paper as an area where a review involving all relevant parties would be undertaken. The Eurosystem would like to reiterate that the provision of ELA is a central bank function and there is an agreement within the Eurosystem on how this facility operates in the euro area. The Eurosystem believes that there are no specific issues relating to the provision of ELA that need to be addressed at the EU level in the context of post-FSAP work.

(c) Deposit insurance

Deposit insurance is an important component of the financial safety net. At the EU level, the regulatory framework is based on the 1994 Deposit Guarantee Schemes Directive, which provides for a minimum level of harmonisation and considerable scope for national discretion. The Eurosystem agrees with the Commission's current initiative to review the existing framework in order to ascertain whether a greater convergence of national schemes is desirable from the point of view both financial integration and financial stability. The Eurosystem and the BSC are contributing to this process from a financial stability perspective. The main areas of this review appear to be the *assessment of existing national differences*, which may become particularly relevant in the case of cross-border banking, and the pursuit of *formal cooperation* between the different national schemes. At present, the number of bilateral agreements

between schemes in the EU is very limited, and these are, almost exclusively, restricted to so-called “topping up” agreements. Moreover, there is little experience of the actual functioning of such agreements in the event of a bank failure. The effective implementation of such arrangements is likely to pose several practical difficulties and may create scope for regulatory arbitrage. The review process could therefore include the development of common principles for bilateral agreements, and the European Forum of Deposit Insurers (EFDI) could play an important role in promoting progress in this area.

6. CONCLUSION

The Eurosystem agrees with the key policy orientation of the Green Paper which focuses on: (i) the consolidation and consistent implementation of the existing legislative framework for financial services to be achieved by exploiting the potential of the existing institutional set-up; and (ii) a better ex-ante and ex-post assessment of new legislative initiatives. The Eurosystem also supports the strands of action suggested by the Commission in the area of financial regulation and supervision that specify the general policy orientation. In particular, the Eurosystem concurs with the importance attached to the objective of rationalising the existing regulatory framework and the pursuit of supervisory convergence.

For its part, the Eurosystem underlines that progress towards further financial integration should be accompanied by efforts at the EU level to continue refining the existing financial stability arrangements. In this regard, some areas (financial stability assessment, management of financial stress, deposit insurance) and related strands of action have been identified as warranting particular attention. In addition, the Eurosystem stresses the importance of market participants pursuing the objective of financial integration, as well as of a comprehensive monitoring of progress in the implementation of the financial services policy.