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FINANCIAL MARKET REGULATION AND SUPERVISION: HOW MANY PEAKS FOR THE EURO AREA?

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I. INTRODUCTION

Financial markets have developed significantly throughout industrialized countries in the last decades of the twentieth century. This path is evident with regard to banking and financial intermediaries, capital markets, and financial instruments. Accordingly, many European nations have either modified their financial systems — regulatory and supervisory — to reflect this development[1] or are currently debating whether to implement such modifications.[2] In Europe, with the start of Phase III of the European Economic and Monetary Union ("EMU"), the responsibility for monetary policy in the euro area has been assigned to the European Central Bank ("ECB"),[3] while banking and financial supervisory tasks have been left to domestic agencies.[4] This development, which reflects "[t]he abandonment of the coincidence between the area of jurisdiction of monetary policy and the area of jurisdiction of banking su-

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1. As is the case most recently with Germany, Austria, Ireland, Portugal and the Netherlands, and earlier in the Scandinavian countries and the United Kingdom.

2. As in the case of Italy and France.

3. Tommaso Padoa-Schioppa, *EMU and Banking Supervision*, 2 INT'L FIN. 295, 297 (1999).

4. *Id.* at 269.

pervision," was a relative novelty in the euro area.[5] This geographical and functional "double separation" between central banking and banking supervision[6], along with the absence of any explicit reference to responsibility for financial stability in the euro area, has cast doubts about the efficacy of the current regulatory arrangements in preventing and managing financial crises.[7] As a consequence, both academic and institutional venues throughout the euro area are now discussing various proposals for financial system regulatory reforms.[8]

Naturally, the first decision lies between choosing either centralized or decentralized financial regulation. National level regulation and supervision are faced with great difficulties within the context of increasing financial markets integration and cross-border mergers among banks, securities firms, and insurance companies. However, the task of fully centralizing regulatory and supervisory activities at the euro level has proven equally challenging, given the current differences in fiscal and commercial codes, and accounting practices across member countries.

This work presents a proposal for the reorganization of regulatory arrangements and supervisory agencies in the EMU. It

5. Tommaso Padoa-Schioppa, EMU and Banking Supervision, Lecture at the London School of Economics Financial Markets Group (Feb. 24, 1999), *available at* http://www.ecb.int/key/sp990224.htm.

6. Padoa-Schioppa, *supra* note 3, at 297.

7. *Id.* at 305.

8. *See* KAREL LANNOO, CENTRE FOR EUROPEAN POLICY STUDIES ("CEPS"), TASK FORCE REPORT NO. 30: CHALLENGES TO THE STRUCTURAL SUPERVISION IN THE EU 34 (2000); Xavier Vives, *Banking Supervision in the European Monetary Union* (1999), *at* http://www.iue.it/FinConEU/vives.pdf; EUROPEAN COMMISSION, INTERNAL MARKET DIRECTORATE GENERAL, INSTITUTIONAL ARRANGEMENTS FOR THE REGULATION AND SUPERVISION OF THE FINANCIAL SECTOR (2000), *at* http://europa.eu.int/comm/internal_market/en/finances/banks/arrange.pdf [hereinafter INSTITUTIONAL ARRANGEMENTS]; THE COMMITTEE OF WISE MEN, FINAL REPORT OF THE COMMITTEE OF WISE MEN ON THE REGULATION OF EUROPEAN SECURITIES MARKETS (2001), *available at* http://europa.eu.int/comm/internal_market/en/finances/general/lamfalussyen.pdf. [hereinafter LAMFALUSSY REPORT]; DIRECTORATE FOR FINANCIAL, FISCAL, AND ENTERPRISE AFFAIRS, ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT ("OECD"), CONSOLIDATED SUPERVISION IN THEORY AND IN PRACTICE 8, Doc. No. DAFFE/CMF (2001) [hereinafter OECD 2001]; Stephen A. Lumpkin, *Supervision of Financial Services in the OECD Area,* 81 FIN. MARKET TRENDS 81, 81–139 (Apr. 2002), *available at* http://www.oecd.org/pdf/M00032000/M00032071.pdf [hereinafter OECD 2002].

argues that with a highly integrated single currency, such as exists in the euro financial system, maintaining only domestically-based regulatory schemes and supervisory practices is inappropriate. At the same time, as stressed in the Lamfalussy Report, full centralization appears difficult to achieve in the near future.[9] Hence, this Article suggests a two-level architecture for financial market regulation and supervision inspired by the European System of Central Banks ("ESCB").[10]

This innovative proposal's theoretical underpinnings for euro area financial market regulation reform, may be found within the new literature on the theory of financial intermediation.[11] This literature emphasizes the similarities rather than the differences among banking and other financial intermediaries.[12] The main similarities include the provision of risk management services to customers, and decreasing the participation costs in ever more complex financial markets.[13] Indeed, the traditional lines that divide financial institutions, instruments, and markets into banking, insurance, and securities sectors have become blurred in advanced industrial countries.[14] Technological, geographical, and functional integration has led to despecialization of the intermediaries and the reduction of the "reserved activities" that previously characterized different types of financial operators.[15] The traditional tripartite division of the financial market (i.e., the banking, insurance, and securi-

9. LAMFALUSSY REPORT, *supra* note 8, at 10.

10. The European System of Central Banks ("ESCB") is composed of the European Central Bank ("ECB") and the national central banks ("NCBs") of all fifteen EU member states. The "euro system" is the term used to refer to the ECB and the NCBs that have adopted the euro as currency. The primary objective of the euro system is to maintain price stability. *See* Organization of the European System of Central Banks, *at* http://www.ecb.int/about/escb.htm (last visited Feb. 28, 2003).

11. *See* Franklin Allen & Douglas Gale, *Financial Markets, Intermediaries, and Intertemporal Smoothing,* 105 J. POL. ECON. 523 (1997); Franklin Allen & Anthony M. Santomero, *Theory of Financial Intermediation,* 21 J. BANKING & FIN. 1461 (1997).

12. George S. Oldfield & Anthony M. Santomero, *Risk Management in Financial Institutions,* SLOAN MGMT. REV. 33, 36 (1997); Allen & Santomero, *supra* note 11, at 1462.

13. Allen & Santomero, *supra* note 11, at 1462.

14. *See infra* Part II.

15. ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, FINANCIAL MARKET TRENDS NO. 81, SUPERVISION OF FINANCIAL SERVICES IN THE OECD AREA 82 (2002) [hereinafter OECD FINANCIAL SERVICES].

ties sectors) failed to consider that the creation and allocation of savings among sectors cash surpluses and cash deficits, were basically unitary phenomena.

The current stream of literature advocates a unitary view of financial intermediation that requires homogeneous regulation.[16] Contrary to the unitary view, the old "institutional" model for financial market regulation and supervision should be dismissed. In such a traditional regulatory model, supervision is over each single category of financial operator, or over each single segment of the financial market, and all supervisory activities are assigned to a distinct agency.[17] In this institutional model, there are three supervisory authorities acting as watchdogs over: (1) banks; (2) financial intermediaries and mutual funds; and (3) insurance companies and their corresponding markets, respectfully. The authorities control intermediaries and markets through entry selection processes (e.g., authorizations and enrolling procedures in special registers), constant monitoring of business activities (controls, inspections, and sanctions) and decisions about exit from the market (suspensions or removal). "Institutional" regulation facilitates the effective realization of controls. Each intermediary and market has to deal with only one, highly specialized supervisory authority. As a result, this type of regulation avoids duplication of controls and reduces regulation costs. The institutional approach seems to be particularly effective for intermediaries specialized in only one of the three segments of the financial sector. However, when different entities are entitled to perform identical financial intermediation activities, the institutional model may induce distortions in the market. For example, financial supervisors impose different rules upon entities that conduct similar financial services whose only difference is their legal status.[18]

The institutional approach's disadvantages are exacerbated by the trend toward multiple-sector activities and by the progressive de-specialization of intermediaries.[19] In turn, these phenomena are connected to the growing integration of finan-

16. OECD FINANCIAL SERVICES, *supra* note 15, at 98.
17. CHARLES GOODHART ET AL., FINANCIAL REGULATION: WHY, HOW, AND WHERE NOW? 144 (1998).
18. *Id.* at 146–47.
19. *See id.* at 143.

cial markets and instruments.[20] In a context where the boundaries separating the various institutions are progressively being erased, it is no longer possible to definitively determine whether particular entities are banks, non-banking intermediaries, or insurance companies. Nor is it easy to determine to what degree and extent such entities are engaged in the various financial activities. Therefore, a risk exists that "parallel" systems of intermediaries may form, reflecting only the diversity of the respective control authorities. In this case, the way that institutional controls are established may actually become a destabilizing factor. Moreover, the financial intermediaries might be induced to organize in such a way that their juridical status is contingent upon the different rules that discipline different institutions.

For all these reasons, the recent trend is in favor of a "level playing field" financial regulation model, providing uniform rules for entities that engage in similar activities. Different models of such "transversal" regulation have been adopted recently or are currently under discussion in Europe and elsewhere. The best known solution is the Single Regulator Model, adopted in the United Kingdom ("U.K.") in 1997, as well as in some Nordic European countries (e.g., Sweden and Denmark), and more recently in Austria and Germany.[21]

This Article argues for a more general policy proposal based on the "transversal" model — recently adopted in Australia — which serves to shift the attention away from supervised institutions to the actual "object" of the supervision.[22] It is centered

20. *See* Richard Dale, *Regulating the New Financial Markets*, *in* RESERVE BANK OF AUSTRALIA, THE FUTURE OF THE FINANCIAL SYSTEM: PROCEEDINGS OF A CONFERENCE (Malcolm Edey ed., 1996), *available at* http://www.rba.gov.au/PublicationsAndResearch/Conferences/1996/Dale.pdf.

21. Michael Taylor & Alex Flemming, *Integrated Financial Supervision: Lessons of Scandinavian Experience,* FIN. & DEV. 42, 42 (1999), *available at* http://www.imf.org/external/pubs/ft/fandd/1999/12taylor.htm. *See also* OECD 2001, *supra* note 8, at 2, 10, 24 n.1.

22. GOODHART ET AL., *supra* note 17, at 149. *See generally* AUSTL. SEC. & INV. COMM'N, ANN. REP. 1999–2000 [hereinafter ASIC ANN. REP.]; OECD 2001, *supra* note 8. In Australia, the Australia Prudential Regulation Authority ("APRA") has identified the coordination of prudential supervision of financial conglomerates as one of its major roles. COUNCIL OF FINANCIAL REGULATORS ANN. REP. 2001, *available at* http://www.apra.gov.au/Policy/loader.cfm?url=/commonspot/security/getfile.cfm&PageID=4835.

on the assignment of different regulatory objectives, or "finalities," to different and independent authorities.[23] These authorities would be competent throughout the financial system, providing homogeneous regulation and supervision regardless of the intermediaries' subjective nature. In the euro area, given the previously mentioned difficulties in choosing a solution between full centralization or decentralization, this Article suggests merging these regulatory models "by objective" into a federal system organized similar to the ESCB. However, it is also argued that the Single Regulator Model may be viewed as a particular case of the regulatory model "by objective," and that the choice between specification or a more complex version depends upon some practical considerations in terms of cost-benefit analysis.

In practice, the proposal advocated in this Article is the establishment of a "European System of Financial Regulators," with either two or three distinct independent authorities along with the ECB at the European level, each being responsible for one or more regulatory objectives. Such a system should characterize these agencies by homogeneous procedures governing their creation, functioning, and funding. In turn, these agencies will push and coordinate the work of their corresponding national authorities within each member country. Under such a regulatory system, at both the European and domestic level, a coordination committee would serve to resolve conflicts and controversies. For this reason, considerable effort would be needed to ensure proper accountability of such independent authorities.

Part II begins with a description of the currently adopted regulatory frameworks for financial markets and intermediaries in the European countries. Part III presents a proposal for a new European architecture for financial market regulation, evaluating the pros and cons of two possible practical and al-

23. The Council of Financial Regulator's role is to contribute to the efficiency and effectiveness of financial regulation by providing a high level forum for cooperation and collaboration among its members including the Reserve Bank of Australia ("RBA"), which chairs the Council, APRA, and the Australian Securities and Investments Commission ("ASIC"). *See* APRA, *at* http://www.apra.gov.au/Policy/The-Council-of-Financial-Regulators.cfm (last visited Mar. 8, 2003). *See also* Government Online Stategy: The Australian Prudental Regulation Authority's Online Action Plan § 2.4, *at* http://www.apra.gov.au/aboutAPRA/ (last visited Mar. 8, 2003) [hereinafter APRA Online Action Plan].

ternative solutions. Finally, Part IV presents an overview of the issues at hand and provides policy prescriptions for the euro area.

II. FINANCIAL REGULATION AND SUPERVISION IN EUROPE: WHERE DO WE STAND?

Economic regulation aims at correcting market imperfections and unfair distribution of resources, while simultaneously pursuing three general objectives: stability, equitable resource distribution, and efficiency. Regulating and supervising the financial system is particularly important, especially since capital accumulation and the allocation of financial resources are essential for growth and development.[24]

The first objective of financial market regulation is the pursuit of macroeconomic stability.[25] Central banks fulfill this objective through macro-controls over currencies (when applicable), interest rates, payment, and (possibly) settlement systems. They also function as lenders of last resort.

The second objective pertains to micro-stability (i.e., prudential regulation) of the intermediaries.[26] Measures targeting this goal are subdivided into two categories: general rules on the stability of all business enterprises and entrepreneurial activities,[27] and more specific rules due to the special nature of financial intermediation.[28]

The third objective of financial regulation is transparency of the market and of intermediaries, i.e., investor protection.[29]

24. *See generally* GOODHART ET AL., *supra* note 17; DAVID LLEWELLYN, THE ECONOMIC RATIONALE FOR FINANCIAL REGULATION, FINANCIAL SERVICES AUTHORITY (1999), RICHARD J. HERRING & ANTHONY M. SANTOMERO, WHAT IS OPTIMAL FINANCIAL REGULATION? (Wharton Fin. Inst. Ctr., Working Paper No. 00-34, 1999).

25. GOODHART ET AL., *supra* note 17, at 189.

26. *Id.* at 5–6, 189. *See also* HERRING & SANTOMERO, *supra* note 24, at 4.

27. Such as the legally required amount of capital, borrowing limits and integrity requirements.

28. Such as risk-based capital ratios, limits to portfolio investments and the regulation of off-balance activities, the managing of deposit insurance funds or investor compensation schemes. *See generally* HERRING & SANTOMERO, *supra* note 24, at 17–19.

29. *See* OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION, INTERNATIONAL ORGANIZATION OF SECURITIES REGULATION § 4.2.2, at 8 (1998) ("Transparency may be defined as the degree to which information about trading (both for pre-trade and post-trade information) is made publicly available

This is linked to the more general objective of equitable distribution of available resources and may be viewed as the search for "equity in the distribution of information as a precious good" among market participants.[30] At the macro-level, transparency rules impose equal treatment (e.g., rules regarding takeovers and public offers)[31] and the correct dissemination of information (e.g., rules prohibiting insider trading and manipulation and, more generally, the rules dealing with exchange microstructures and price-discovery mechanisms).[32] At the micro-level, such rules aim at guaranteeing non-discrimination in the relationships among intermediaries and different customers by establishing conduct of business rules.[33]

The fourth objective of financial market regulation, linked with the general objective of efficiency, is the safeguarding and promotion of competition in the financial sector.[34] This type of regulation requires rules for controlling market power and structures, which at the micro level involves mergers and acquisitions regulations, as well as safeguards against cartels and abuses of dominant position. Specific controls over financial intermediaries and markets may be also justified as an attempt to limit destabilizing excesses generated by tough competition in this important sector.

In order to pursue these enumerated objectives, there is neither a unique theoretical model nor a practical approach to the regulation and supervision of financial markets. Literature on these matters identifies significant differences in both the definitions and classifications of regulatory models and techniques.[35] In reality, it is also difficult to observe the adoption of regulatory schemes that are fully consistent with only one theo-

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on a real-time basis."). *See also, e.g.,* CLIVE BRIAULT, THE RATIONALE FOR A SINGLE NATIONAL FINANCIAL SERVICES REGULATOR, FINANCIAL SERVICES AUTHORITY 10 (1999). *See also*, HERRING & SANTOMERO, *supra* note 24, at 9.

30. *See* HERRING & SANTOMERO, *supra* note 24, at 6–8. *See generally* Allen & Gale, *supra* note 11.

31. *See* HERRING & SANTOMERO, *supra* note 24, at 7–8.

32. *See* BRIAULT, *supra* note 29, at 10. *See also* HERRING & SANTOMERO, *supra* note 24, at 9–10.

33. *See* HERRING & SANTOMERO, *supra* note 24, at 7–8.

34. *See*, Lawrence J. White, *International Regulation of Securities Markets: Competition or Harmonization?*, *in* THE INDUSTRIAL ORGANIZATION AND REGULATION OF THE SECURITIES INDUSTRY 208, 219–21 (Andrew W. Lo ed., 1996) [hereinafter White, *International Regulation of Securities Markets*].

35. *See generally* OECD 2002, *supra* note 8.

retical model. A glance at the European Union's current state of financial market regulatory and supervisory arrangements confirms this, making it evident that multiple regulatory schemes often are in effect.[36]

In each European country, financial markets regulation has been affected by the structure and the evolution of the domestic financial system as well as by the legal system in place.[37] In general, national regulation first focused on banking intermediaries, given their traditional dominant role in continental Europe's financial sector.[38] Most of the recent changes in member countries came about as a result of pressure brought on by EC directives and from increased cross-border financial market integration, which at first stimulated and then followed the 1992 single market program.[39] However, despite EU member countries' implicit commitment to ensuring the adequate regulation and supervision of financial sectors, no European law deals with the problem of how to regulate and supervise financial markets and intermediaries.[40] As a consequence, the EU currently utilizes a combination of different regulatory approaches. Moreover, many member countries also lack a "pure" regulatory model that applies throughout the national financial system.

The Nordic European countries (in particular, Sweden and Denmark), the U.K., Austria, and Germany, have chosen to delegate financial regulation and supervision to a unified

36. *See infra* Figure 1. *See generally id.*

37. *See generally* OECD 2002, *supra* note 8.

38. *See, e.g., id.* at 85.

39. Moreover, in many member countries no "pure" regulatory model is adopted throughout the national financial system. *Id.* at 109–19.

40. *Id.* at 116. Sweden's "single integrated agency" is known as *Finansinspektionen*, which was structurally changed into one agency in September 2000. *Id.* at 116. In Denmark, financial services are supervised by the *Finanstilysynet*, which was created in January 1988. *Id.* at 117. In the U.K., financial services are supervised by the Financial Services Authority, which was created in late 2001, and is subject to the Financial Services and Markets Act of 2000. *Id.* Germany consolidated its various supervisory agencies into the Federal Agency for Financial Market Supervision, or the *Bundesanstalt für Finanzdienstleistungsaufsicht*. *Id.* at 109. In April 2002, Austria also adopted a single regulatory model. *Id.* at 113–14. *See* Carmine Di Noia & Giorgio Di Giorgio, *Should Banking Supervision and Monetary Policy Tasks be Given to Different Agencies?*, 3 INT'L FIN. 361, 366 (1999).

agency, separated by the central bank.[41] This regulatory approach is a coherent and integral application of the Single Regulator Model, based on just one control authority with responsibility over all markets and intermediaries, regardless of whether in the banking, financial or insurance sector.[42] Such regulatory authority concerns itself with all the objectives of regulation, but in particular with microeconomic stability and investor protection.[43] Recently, Ireland commenced and France announced projects aimed at establishing a new single regulatory agency for financial services in order to consolidate prudential supervision and investor protection across the financial sector.[44]

In most other EU countries, the traditional "institutional" model seems to still be in effect for the insurance sector, in spite of the increasing role of insurance companies as important financial intermediaries. In Belgium, Luxembourg, and Finland, a separate agency is responsible for supervision of banking activities, securities markets, and investment funds and firms, but none exist for insurance. As a matter of fact, contracts involving life insurance and capitalization provide services that are directly tied to investment funds, stock exchange, or other financial indices (i.e., unit-linked or index-linked contracts). All major financial systems should accept the financial regulation of life insurance, since the distinctiveness of most schemes of life insurance, compared to other financial products, has lessened considerably.[45]

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41. *See* OECD 2002, *supra* note 8, at 109, 116–17.

42. *Id.*

43. *Id.* at 118. Ireland's supervisory agency will be known as the Irish Financial Services Regulatory Authority. *Id.*

44. *Id.* at 112–15.

45. In the U.K. system, for instance, long-term life insurance contracts are included under investments (financial instruments) as provided by the Financial Services Act 1986 ("FSA"). The recent establishment of the FSA will further reduce the distinctiveness of insurance companies by applying a common regulation to all financial institutions. Under the U.S. system, variable annuities and variable life insurance contracts whose yield is tied to "separate accounts," fall under the Investment Company Act of 1940, ch. 686, tit. I, 54 Stat. 789 (codified as amended at 15 U.S.C. §§ 80a-1 to 80a-52 (2000)), which provides the general guidelines relative to investment activities. In the euro area, on the contrary, insurance companies are generally excluded from the set of rules that apply to banks and to other financial intermediaries. In most countries, life insurance policies are not considered financial instruments and

A specialized "institutional" supervisor is also widely in place for the securities market. However, in countries such as Italy and Portugal, security supervisors are only responsible for investor protection, since the central bank assumes the role of safeguarding stability objectives. In this case, the regulatory model by objective applies in part. Another partial application of this model is found in recent Dutch reform.[46] The Netherlands established a single authority for financial market transparency and investor protection, while leaving the supervisory responsibility for microeconomic stability, to either the central bank, for banking and securities, or to a separate agency dedicated to insurance and pension funds.

In many EU countries, banking supervision is one of the functions of the national central bank. However, in some countries, such as Belgium, Luxembourg, Finland, and to an extent France, this task is assigned to a separate agency, or is performed jointly by the National Bank and another agency.[47] In fact, there is a long debate among monetary economists on whether banking supervision and monetary policy responsibilities should be vested in the same institution, namely — the central bank.[48] Although no consensus among the scholars has been reached, there is a general preference towards separating the two functions.[49] The euro area currently overcomes this

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insurance companies are not authorised to perform investment services. Although there is an increasing tendency to recognise the high degree of contiguity between certain insurance products and other financial products, the regulatory differences remain significant and insurance companies are supervised and controlled by a specialized supervisory authority with the exception of Austria and Ireland, where responsibility is given to a government department. In Austria, the government is directly responsible for regulating and supervising the entire financial system, although a recent proposal aims at introducing a separate and dedicated independent agency along the lines of the FSA.

46. *See* OECD 2002, *supra* note 8, at 109–19.

47. VIVES, *supra* note 8. *See also, e.g.,* OECD 2002, *supra* note 8, at 109–19 (reporting on the banking supervisions of EU members including Belgium, Luxembourg, Finland, and France).

48. *See also* RICHARD K. ABRAMS & MICHAEL TAYLOR, ISSUES IN THE UNIFICATION OF FINANCIAL SECTOR SUPERVISION 19–21 (IMF, Working Paper, 2000); Charles Goodhart & Dirk Schoenmaker, *Institutional Separation Between Supervisory and Monetary Agencies*, 51 GIORNALE DEGLI ECONOMISTI E ANNALI DI ECONOMIA 339–58 (1993).

49. Goodhart & Schoenmaker, *supra* note 48, at 337; Di Noia & Di Giorgio, *supra* note 40, at 362–63.

problem, however, because the national central banks, even when acting as financial supervisors, are no longer technically in charge of monetary policy.[50] Figure 1 summarizes the current structure of financial supervision in the EU.

Regionally, the process of financial integration followed quite heterogeneous paths. With regard to the intermediaries, ownership integration has developed through an increasing number of mergers and acquisitions and the establishment of new alliances directed to diversify the business, either geographically or functionally. Even though the process is still characterized by a dominant share of domestic deals, cross-border operations have recently become more important and are likely to develop further in the near future.[51] Currently, traditional banking's prominent role in continental Europe is being challenged by advances in information and delivery technology, and by the entry of new and aggressive financial industry players.[52] While information and delivery technology advances have the effect of lowering barriers to entry in banking and finance, the appearance of aggressive new financial players contributes to the erosion of the traditional banks' monopoly, and comparative advantages in information gathering, monitoring, delivery capacity and processing.[53] In fact, European financial market liberalization also started a deep process of business restructuring across the entire financial sector. The search for economies of scale led to a reduced number of banks, insurance, and financial firms which in turn lead to a considerable increase in market concentration. For these reasons, financial conglomerates gradually become more important, tending to act more and more on an international basis — both at a European and global level.

Considerable integration has taken place between the banking, insurance, and securities markets.[54] In most EU countries, banks and insurance companies are among the most important issuers of stocks and other securities traded in both organized

50. *See* Padoa-Schioppa, *supra* note 3, at 297.

51. Alberto Cybo-Ottone et al., *Recent Development in the Structure of Securities Markets*, *in* BROOKINGS-WHARTON PAPERS ON FINANCIAL SERVICES 223, 234, 238 (R. Litan & A. Santomero eds., 2000).

52. Padoa-Schioppa, *supra* note 3, at 299.

53. *Id. See also* LANNOO, *supra* note 8, at 5.

54. Goodhart & Schoenmaker, *supra* note 48, at 336.

exchanges and over-the-counter. Financial products and instruments have also experienced a certain degree of integration, sometimes changing their original economic function.[55] In general, financial products have become increasingly complex, calling for new and enhanced skills in regulatory and supervisory activities. Furthermore, the EMU increased the level of substitutability between national government and corporate bonds because differences in interest rates across member countries vanished. The euro is also impacting the demand side of the stock exchanges' business by making them quasi-perfect substitutes. For example, even though the most important exchange in Europe, the London Stock Exchange, belongs to a non-euro country, a sufficient number of regulatory and fiscal differences between EMU countries still exist.[56]

The adoption of the single currency will speed up a naturally ongoing process of market integration towards financial conglomeration in Europe.[57] Supervising organizations are not necessarily a minor challenge for regulators. If it is true that risk diversification might be within reach, the possibility of excessive risk concentration also exists, especially when a domestic-based regulator looses control over the many internationally linked activities of the supervised entities.[58] Risks at group level do not always coincide with the sum of individual risks. Moreover, larger balances may allow for more creative accounting.

There is no point in having a common monetary policy and aiming at an integrated financial system in the euro area while keeping different financial regulations and supervising rules in each member country. As a matter of fact, these national insti-

55. ALESSANDRO PRATI & GARRY J. SCHINASI, FINANCIAL STABILITY IN EUROPEAN ECONOMIC AND MONETARY UNION 59–66 (Princeton Studies in Int'l Fin., No. 86, 1999). *Cf.* LAWRENCE J. WHITE, TECHNOLOGICAL CHANGE, FINANCIAL INNOVATION, AND FINANCIAL REGULATION: THE CHALLENGES FOR PUBLIC POLICY 31–33 (Wharton Fin. Inst. Ctr., Working Paper No. 97-33, 1997), *at* http://fic.wharton.upenn.edu/fic/papers/p9733.htm [hereinafter WHITE, TECHNOLOGICAL CHANGE] (noting the change of financial products and instruments in the U.S.).

56. *See generally* Roberta Karmel, *The Case for a European Securities Commission,* 38 COLUM. J. TRANSNAT'L L. 9, 33, 42 (1999).

57. *See generally* VIVES, *supra* note 8, at 6–8, 20.

58. Franco Bruni & Christian de Boissieu, *Lending of Last Resort and Systemic Stability in the Eurozone,* SUERF Studies 41 (2000).

tutional differences serve as barriers to further financial integration and may very well prove to be an impeding factor toward a smooth transition to the EU's single monetary policy.[59] In the field of financial regulation, the principle of minimum harmonization and mutual recognition, which originally was thought to be able to naturally induce a convergence of regulatory behavior and more uniform rules over time, did not work. Moreover, there is a concrete risk that competition in this area will not even generate the more efficient outcome. On one side, an incentive exists to promote less demanding domestic financial regulations and supervision in order to let each country become more attractive on their own for running financial business.[60] On the other side, it is not clear who will pay the costs of potential insolvency following excessive risk taking behavior and financial misconduct in a member country.[61] Finally, with increasing international banking activities and a European real-time gross settlement system in place (e.g., the Trans-European Automated Real-time Gross Settlement Transfer System ("TARGET")),[62] the argument that domestic regulators and supervisors have better knowledge and can exercise more efficient control is becoming less persuasive.[63]

Another important point is that no clear tool of responsibility for countering and/or managing the risk of financial instability and crisis has been established in Europe.[64] The EC Treaty is silent on this topic.[65] It is not even evident that the ECB will perform the role of lender of last resort,[66] which would be desirable because the ECB functionally acts as a central bank. In fact, only in the case of a wide-spread liquidity crisis affecting the whole euro area, would the ECB likely assume such a role.[67]

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59. VIVES, *supra* note 8, at 19.
60. *Id.* at 5.
61. *See infra* notes 75–77.
62. TARGET is the payment system of the ESCB. *See* VIVES, *supra* note 8, at 9.
63. *See* Prati & Schinasi, *supra* note 55, at 44.
64. *See* Bruni & de Boissieu, *supra* note 58, at 41, 43, 45.
65. *See* TREATY ESTABLISHING THE EUROPEAN COMMUNITY, Nov. 10, 1997, O.J. (C 340) 3 (1997) art. 105; Di Noia & Di Giorio, *supra* note 40, at 363 n.4; VIVES, *supra* note 8, at 9, 21.
66. *See* Bruni & de Boissieu, *supra* note 58, at 41.
67. *See* VIVES *supra* note 8, at 18 (discussing the ECBs possible involvement).

But it is unclear what would follow a liquidity crisis located in a single member country, or a general solvency crisis.[68]

For these reasons, the EMU needs a higher degree of coordination in the field of financial regulation and prudential supervision. Both regulation and supervision require further harmonization as financial market integration evolves.[69] Such harmonization attempts are currently observable among mergers and acquisitions of stock exchanges.[70] Moreover, Internet development fosters distribution channels for financial services that will render the physical location of the financial firms irrelevant, and will pose additional regulatory problems. In addition, there continues to be a trend towards increasing cross-border mergers among intermediaries, groups, and conglomerates, as well as the dual and cross-border offerings and listings of securities.[71] However, harmonization does not necessarily mean complete centralization. If it is too late to continue with different national regulators and supervisors, it is probably too early for having one or more central regulator(s) and supervisor(s) for the entire euro area. Indeed, not only is the euro area too large, but too many different rules still exist[72] and fiscal

68. Suppose we face a situation in which a single financial institution located in a member country is in trouble. What kind of intervention, if any, is currently allowed? One of the typical forms of public intervention seems lost, and probably the most natural, that of central bank last resort loans. *See* GOODHART ET AL., *supra* note 17, at 353; Xavier Freixas et al., *Lender of Last Resort: A Review of the Literature,* 7 FIN. STABILITY REV. 151, 154–57 (1999), *available at,* http://www.bankofengland.co.uk/fsr/fsr07art6.pdf. The ECB will not intervene in favor of a single institution, especially if its financial links are mostly domestic, because it could always assign some of the responsibility for the crisis to the domestic financial regulator-supervisor. The domestic central bank can not intervene by providing funds without an explicit authorization by the ECB. In this case, it will have to convince the latter that the institution is facing a liquidity and not a solvency crisis, according to the old Bagehot's doctrine, and/or that the risk of potential spread and contagion of the crisis is high. This requires time and resources. The other two traditional instruments, bail out through a safety net provided by the banking system or through the government budget will ultimately shift the burden on the shoulders of domestic taxpayers.

69. Padoa-Schioppa, *supra* note 3, at 300. *See* Dale, *supra* note 20. *But cf.* WHITE, TECHNOLOGICAL CHANGE, *supra* note 55, at 28.

70. *See* Cybo-Ottone et al., *supra* note 51, at 239.

71. *Id.* at 238.

72. For example, rules for commercial codes, company laws, failure procedures, corporate governance, etc.

policies have yet to be harmonized. In addition, national enforcement might still be desirable in most cases. Thus, the only feasible solution is the federal approach to financial regulation and supervision, which could be organized with a structure similar to the one established for monetary policy with the ESCB. The next section examines the regulatory model best suited for the entire euro area, and suggests two feasible institutional architectures to implement such a plan.

III. REGULATION "BY OBJECTIVE" IN THE EURO AREA

The selection of a feasible regulatory model for the entire euro area presents formidable challenges. To begin, the old "institutional" model could be considered a good candidate, but only in a context with rigidly separated financial segments, and where no global players are at stake. But this scenario does not apply to the euro area where a high degree of integration in financial markets and intermediaries as well as multifunctional groups and conglomerates are rapidly growing.[73] Discounting the institutional model, the choice is narrowed down to one of the transversal models — the "by objective"[74] approach and the Single Regulator Model[75]

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73. *See generally* LANNOO, *supra* note 8.

74. LLEWELLYN, *supra* note 24, at 8, 9.

75. A third "transversal" model is the termed "functional supervision," or supervision "by activity." Although never fully applied in practice, this approach assumes the economic functions performed in the financial system, but does not postulate that existing institutions must necessarily continue to exist as such, in terms of both their structure and role. The financial system is considered to perform some basic functions, including: provision of clearing and settlement services; resource pooling; portfolio diversification; provisioning of ways of transferring economic resources through time, across borders, and among industries; risk management services; price information discovery; and reduction of informational asymmetries. These "functions" or activities, undertaken by financial markets and intermediaries, are considered to be more stable than the institutions currently performing them. Robert Merton & Zvi Bodie, *A Conceptual Framework for Analyzing the Financial Environment*, *in* THE GLOBAL FINANCIAL SYSTEM: A FUNCTIONAL PERSPECTIVE 3, 12–16 (Dwight B. Crane et al. eds., 1995).

In the "functional supervisory" model, each of these activities should be regulated by a given authority independently of the operator who offers it. Hence, also this approach has the important advantage that it calls for the same rules to be applied to intermediaries who perform the same activities. Moreover, it fosters economies of specialization within the supervisory authorities and might represent a rather attractive solution for the regulation of inte-

The single regulator solution aims at reaching a more efficient organization of supervisory activities, including a reduction in the costs of regulating itself.[76] The advantages of this approach lie in the economies of scale that it produces — fixed costs, logistical expenses, the administrative personnel costs, and executive management compensation costs are all considerably reduced.[77] Moreover, this regulatory scheme calls for a unified view which is particularly useful and effective with respect to multifunctional groups and conglomerates. By the same token, the costs of supervision charged to those regulated and/or to taxpayers decrease, and there is less room for "regulatory arbitrage."[78] In addition, it is considered useful to have just one agency accountable to the market and to legislative oversight.[79] However, the validity of this model strongly depends on its internal organization: if the numerous areas of competence and specialization are not well-structured and coordinated, the decision-making process risks slowing down. James Q. Wilson in his seminal work on bureaucracy noted that what counts is a clear definition of an agency's "mission."[80] Moreover, the presence of a sole regulator might foment and accelerate collusive relations between the regulator and the regulated (i.e., "regulatory capture.")[81] Finally, this model might exacerbate problems of self-contradiction in the event that the authority should find itself forced to pursue conflicting supervisory objectives.[82] However, an internal organization divided "by objectives" might partially surmount this problem,

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grated, advanced financial markets. However, it has numerous drawbacks. In particular, this model envisions an overlapping of bodies controlling the same subject: there is the risk of an excessive division of powers and responsibilities among the regulatory agencies. A further disadvantage of the functional approach is that finally what is subject to failure is not the activity performed, but the institution. In case of serious problems of stability, it would be essential to guarantee protection and oversight with regard to the institutions rather than to individual operations.

76. *See* BRIAULT, *supra* note 29, at 18–23.

77. *Id.* at 18–20.

78. *Id.* at 19.

79. *See id.* at 18.

80. *See* JAMES Q. WILSON, BUREAUCRACY 101, 109-110 (1989). *See also* ABRAMS & TAYLOR, *supra* note 48, at 6.

81. *See* WILSON, *supra* note 80, at 83–84; ABRAMS & TAYLOR, *supra* note 48, at 16.

82. *See* ABRAMS & TAYLOR, *supra* note 48, at 17.

although the fact that executive management is one of the subject-matter objectives may lead to the creation of a prevalent "single objective" as far as the decision-making process is concerned.[83]

The possible conflict of interest, or trade-off, in pursuing different objectives is of particular interest when they are assigned to the same agency.[84] Under this type of regime, the Single Regulator Model is affected by the possible incompatibility among different supervisory objectives.[85] In the credit sector, for instance, there exists a clear trade-off between competition and stability, at least in the short run. The need to safeguard stability in moments of economic and financial tension led to the use of instruments designed to limit competition, such as institutional barriers to market entry, or to the introduction of legal limits to certain activities.[86] In countries where banks are still dominant national players in the financial sector, but not efficient enough to compete cross-border (e.g., Spain, Italy, Germany), the objective of competition is more easily sacrificed than stability.[87] The consequence is a "stable" environment in terms of the number and identity of intermediaries. But this stability may also be obtained by altering the free play of competition with measures that prevent exit of inefficient actors from the market.

Potential conflict may also develop between the objectives of stability and transparency (investor protection). Again, with regard to the banking sector, scarce transparency in fund gathering activities, for example in the issuance of securities, might allow the application of interest rates at below-market rates. Such behavior could be considered functional to the strengthening of banking's stability, but it would inevitably result in direct injury to investors. The most immediate response to this important problem might be to attribute to different authorities seperate supervision objectives by adopting the regulatory model "by objectives" as the benchmark for advanced financial systems.

83. *See id.*
84. *See id.*
85. *See id.*
86. *Id.*
87. *See* Padoa-Schioppa, *supra* note 3, at 298.

The supervisory model "by objectives," or by finalities, postulates that all intermediaries and markets be subject to the control of more than one authority — each single authority then remains responsible for each regulation objective regardless of the legal form and functions, or activities that the intermediaries perform.[88] According to this scheme, the first authority watches over prudential regulation and micro-stability of both markets and all intermediaries, regardless of whether in banking, finance, or insurance. Such an agency should supervise the stability of the entire financial market and of individual financial intermediaries by licensing authorizations, controlling professional registers, performing inspections, issuing sanctions, and managing crises. Authorities operating under this model should cooperate with the second authority — the Central Bank — which is responsible for monetary policy and macro-stability, including supervising security settlement and payment systems, clearing houses, and in monitoring the use of financial instruments in wholesale markets.

The third authority under this model is responsible for transparency and investor protection. It should supervise disclosure requirements, the behavior of intermediaries, and the orderly conduct of trading in all financial intermediation activities that banking, securities, and life insurance intermediaries perform.[89] Moreover, such an authority should be assigned powers of regulating misleading advertising by financial intermediaries. Finally, it should also control macro-transparency in financial markets, including the discipline of insider trading, takeovers, and public offers.

A fourth authority should guarantee fair competition, and should guard against abuses of dominant positions and limit dangerous concentrations in banking, security, and insurance sectors. A diagram of this "four-peak" model for financial regulation is provided in Figure 1.

Australia recently chose this form of solution, and it appears particularly effective in a highly-integrated market context, as well as in the presence of multifunctional operators, conglomerates, and groups operating in a variety of different business sec-

88. *See* GOODHART ET AL., *supra* note 17, at 156–57. *See also* OECD 2002, *supra* note 8, at 99-101.

89. Including discipline and control in the area of transparency in contracts.

tors. The "four-peak" model's most attractive feature is that it provides uniform regulation for different entities engaged in similar activities. At the same time, this model does not require excessive proliferation of control units.

Australia's Financial Sector Reform Act of 1999 harmonized financial rules and supervision assignments at the Commonwealth level.[90] The Australian Securities and Investments Commission ("ASIC") protects investors, superannuates, depositors, and insurance policy holders.[91] This agency regulates and enforces laws that promote fairness and proper behavior within the financial markets and exchanges as well as among financial firms and advisors.[92] The ASIC cooperates with three other primary regulatory bodies at the Commonwealth level. For example, the Australian Prudential Regulation Authority ("APRA"), established in 1998, is responsible for ensuring that financial institutions will honor their commitments.[93] The APRA currently safeguards the soundness of deposit-taking institutions, insurance companies, and other financial firms after having inherited the powers and duties previously held by the Australian Central Bank and the Insurance and Superannuation Commission.[94] Monetary policy and systemic stability are assigned to the Reserve Bank of Australia, which is the third institutional member represented in the Council of Financial Regulators, the official site that fosters coordination efforts and resolves conflicts.[95] Finally, the fourth agency, the Australian Competition and Consumer Commission, is charged with antitrust powers and responsibilities.[96]

It is too early to evaluate the success of Australia's recent reforms. ASIC's 1999–2000 Annual Report indicates noticeable improvements in the speed of completing both corporate and

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90. Financial Sector Reform Act, 1999 (Austl.) (repealed).

91. For more information on the Australian Securities and Investments Commission ("ASIC"), see website at www.asic.gov.au/asic/asic.nsf (last visited Mar. 1, 2003).

92. *Id.*

93. *See also* APRA Online Action Plan, *supra* note 23.

94. *Id.*

95. *See generally* Reserve Bank of Australia, *at* www.rba.gov.au/AboutTheRBA.htm (last visited Mar. 2, 2003).

96. *See generally* Australian Competition and Consumer Commission ("ACCC"), *at* www.accc.gov.au/about.htm (last visited Mar. 2, 2003).

market investigations and in the registration of prospectuses.[97] In addition, stemming from Australia's financial reform, the largest number ever of unqualified people were banned from giving investment advice, and 84% of the 461 court cases challenging the ban were upheld.[98] Results from an ASIC benchmarking survey also indicate improved public perception of the effectiveness in regulating financial reporting, corporate disclosure, market integrity and law enforcement.[99]

In 2001, however, HIH Insurance Ltd. ("HIH"), the second largest insurance company in Australia, collapsed.[100] Mounting criticisms of this insolvency brought the new prudential authority, APRA, under pressure.[101] Nevertheless, many of the problems leading to HIH's failure had originated during the previous regulatory scheme. In fact, the APRA publicly recognized the weakness in the previous insurance sector regulation, under the Insurance Act of 1973, and launched a thorough reform, which will be implemented in the near future.[102] Regardless, the Australian Government criticized APRA for its untimely intervention and appointed a Royal Commission to examine case and assess responsibility.[103]

Compared to the "institutional" or the Single Regulator Model, a regulatory framework organized "by objectives" obvi-

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97. *See generally* ASIC ANN. REP., *supra* note 22.

98. *Id.*

99. *Id.*

100. Charles E. Boyle, *Australian Insurer HIH Seeks Bankruptcy Protection as Losses Mount*, INS. J., Apr. 9, 2001, *at* www.insurancejournal.com/magazines/west/2001/04/09/features/17957.htm; David Kehl, E-Brief: HIH Insurance Group Collapse, Parliament of Australia, Department of the Parliamentary Library, *at* http://www.aph.gov.au/library/INTGUIDE/econ/hih_insurance.htm (last visited Feb. 11, 2003).

101. Paul Cleary, *APRA's shortcomings spelt out,* AUSTL. FIN. REV., Sept. 6, 2001, at 6.

102. *Id.* *See also* Insurance Act, 1973 (Austl.), *available at* http://scaleplus.law.gov.au (last visited Mar. 2, 2003); Press Release, No. 02-56, APRA: Both the regulator and the industry have learnt from HIH (Nov. 29, 2002), *available at*.http://www.apra.gov.au/internetapps/Print_Media_Page.

103. Press Conference, Transcript of the Prime Minister, The Hon. John Howard, MP Joint Press Conference with Minister Joe Hockey (Parliament House, Canberra, May 21, 2001), *available at* www.pm.gov.au/news/interviews/2001/interview1060.htm; HIH Royal Commision, Proposed Terms of Reference, June 18, 2001, *available at* www.pm.gov.au/news/media_releases/2001/media_release1100.htm.

ously produces a certain degree of multiple controls.[104] Such regulations may also lead to a lack of other controls, since specific assignment of responsibilities with respect to the objectives of regulation are not necessarily univocal and all-inclusive in practice.[105] Since each intermediary is subject to the control of more than one authority, this regulatory model might also prove more costly.[106] For example, the intermediaries might in fact be required to produce several reports relating to their supervision, which may often contain identical or similar information. The intermediaries may also have to justify the same action to a whole set of authorities contemporaneously, though each for different reasons. *Vice versa*, a deficit of controls might occur whenever the exact areas of responsibilities are not clearly identifiable. Finally, in order to be effective and to avoid the conflicts of interest, a regulatory model organized "by objectives" needs a coordination committee consisting of all the different authorities as well as the central bank.[107]

In practice, however, the difference between the Single Regulator Model and the one "by objectives" is not as relevant. Actually, since it is often the case that antitrust responsibilities in the financial sector are assigned to a dedicated agency, and since the central bank remains in charge of macroeconomic stability, the Single Regulator Model acts as a "three-peak" regulatory model "by objective," in which the two objectives of microeconomic stability — prudential supervision and investor protection — are assigned to a unique agency.[108] In this light, the choice between one of the two alternatives has to be made pragmatically — by comparing the likely costs deriving from conflicts of interest among agencies simultaneously pursuing the targets of microeconomic stability and investor protection,

104. *See* Consolidated Supervision in Theory & Practice, Directorate for Financial, Fiscal, & Enterprise Affairs, Committee on Financial Markets 4 (Mar. 7, 2001) [hereinafter Consolidated Supervision]; GOODHART ET AL., *supra* note 17, at 156–57; LLEWELLYN, *supra* note 24, at 49.

105. *See* BRIAULT, *supra* note 29, at 11.

106. *See, e.g.*, *id.* at 6.

107. *See, e.g.,* LANNOO, *supra* note 8, at 34.

108. *See* Consolidated Supervision *supra* note 104, at 8.

with those costs of establishing one additional agency and its attendant bureaucracy.[109]

A. Financial Regulatory Proposal for the Euro Area

This Article advocates that a modification of the current regulatory structure in the euro area's financial sector would solve some problematic issues regarding financial stability and address the need for greater coordinated transparency and investor protection rules. Of course, structuring and creating such an integrated system of rules and institutions in the EU is far from easy; such a change will require time, resources, political support, and widespread collaborative attitude. Nevertheless, it is hoped that this Article will at least constructively contribute to the current discussion.

As already stressed, whether financial regulation in the euro area should be fully centralized at the European level, or improved through more adept harmonization at the regional level is a difficult question to answer. Many arguments support the view of centralizing and unifying financial regulation in the euro area.[110] However, the feasibility and opportunity of a European centralized solution is diminished by the observation that the euro area might be too large to be controlled by one or two central agencies. Many different rules are still in place with respect to commercial codes, company laws, corporate governance schemes, failure procedures and so on. EU directives, when they actually exist, do only establish a common floor. Different fiscal policies are still in place even with a single currency and a common monetary policy. Furthermore, the EU's taxation of both financial services and other items still lacks homogeneity. In any case, some form of national enforcement is probably still needed.

Hence, the EU should establish a European System of Financial Regulators ("ESFR"), structured similarly to the ESCB and

109. *See generally* Christian Hawkesby, *The Institutional Structure of Financial Supervision: A Cost-Benefit Approach,* 2 J. INT'L BANKING REG. 36 (2000).

110. *See, e.g.,* WHITE, TECHNOLOGICAL CHANGE, *supra* note 55. In particular, an integrated supervision on markets and intermediaries would be valuable in a scenario dominated by conglomerates and characterized by the expansion of electronic communication networks, market manipulation and trades on the net.

organized according to the "by objective" model of regulation, which includes the single regulator solution as a particular case. A European Central Authority ("ECA"), separated from the ECB, should be at the system's center for each objective of regulation. In a first stage (lasting for, perhaps, three years), these authorities would be able to harmonize and coordinate financial regulation in member countries, design common principles and guidelines for prudential supervision, and set out appropriate disclosure instruments and requirements. The EU members should sponsor the institutional changes at the domestic level necessary for these institutions to merge and reorganize the supervisory and regulatory powers within the financial sector of each member country. At the end of this process, each country should have only one national agency responsible for each objective of financial market regulation. Each national agency will then participate according to the area's general strategies and principles of financial regulation, becoming a member of the ESFR. These agencies will then implement the rules and the supervisory duties agreed upon at the euro level within their respective country.

The "four-peak" reform model calls for the establishment of two new European agencies — one responsible for microeconomic stability ("European Financial Supervision Authority") and the other responsible for oversight of financial intermediaries regarding transparency in the market, investor protection, and disclosure requirements ("European Authority for Market Transparency"). These two central agencies should then coordinate among the different domestic agencies in each member country. Apart from this vertical form of coordination, cooperation should be engaged horizontally, at both the EU and national levels. The coordination and resolution of eventual controversies could be provided by special commissions for the supervision of the financial system established at the European Commission and national treasuries.[111] These commissions would serve as the breeding ground for proposals and consultations concerning financial market regulation.

Under this regulatory proposal, no member of the ESFR should have antitrust power so as to avoid the trade-off between

111. E. GERALD CORRIGAN, FINANCIAL MARKET STRUCTURE: A LONGER VIEW, ANNUAL REPORT FEDERAL RESERVE BANK OF NEW YORK (1987).

competition, and stability, and transparency. Moreover, since agencies responsible for supervising market competition currently exist at both European and national levels, it would be wise to establish an additional independent central agency — the EU Antitrust General Direction. This agency would then coordinate and promote domestic antitrust agencies. In each member state, the national antitrust agency would be able to safeguard competition in all economic sectors. The proposed "four-peak" model for financial regulation in the EU is schematically presented in Figure 2.

Admittedly, this Article's proposed regulatory structure is indeed ambitious, requiring a substantial amount of coordination among the different authorities. An additional and delicate challenge is that of the accountability of these new and existing independent agencies, a topic that while deserving of separate investigation, lies beyond the scope of this Article. Another important obstacle would be the institutional and political resistance by current national agencies, who would not passively accept the abolishment or weakening of their regulatory powers. For such reasons, the alternative solution of merging financial supervision authority and market transparency agencies into a single regulator may provide a practical solution. A single regulator under this model would diminish the costs of bureaucracy and regulation, and make coordination efforts easier.[112] At the same time, possible conflicts of interest in pursuing investor protection and microeconomic stability, although present, are certainly less relevant than the conflicts of interest between stability and efficiency.[113] In a "three-peak" model, the single European Central Authority for financial market regulation would cooperate with the ECB for the purpose of macroeconomic stability.[114] The ECA would also organize and coordinate the work of various domestic agencies, which in different countries could be either specialized "by objective"[115] or could be re-

112. *See generally* Julian R. Franks et al., *The Direct Compliance Costs of Financial Regulation*, 21 J. BANKING & FIN. 1547 (1997).

113. *See id.* at 1563–64.

114. *See* OECD 2001, *supra* note 8, at 5; OECD 2002, *supra* note 8, at 16, ¶ 50.

115. *See* OECD 2002, *supra* note 8, at 15, ¶ 46, fig. 6.

sponsible for both market transparency and stability as the Financial Services Authority is in the U.K.[116]

In fact, a good example of international cooperation and coordination efforts can presently be found within banking supervision of the Basle Committee, which works on a wide range of topics, employing no formal by-laws, but which maintains a very strong leadership.[117] Furthermore, many institutional arrangements for the regulation and supervision of the financial sector at the EU level already exist. The most important are the Banking Advisory Committee and the Insurance Committee,[118] both possessing comitological powers.[119]

In contrast, securities supervision did not succeed in establishing a similar long record of international rule-making or an EU securities committee capable of comitological powers.[120] The European supervisory system would gain both in consistency and effectiveness if all stability-oriented rules, all transparency-oriented rules, and all competition-oriented rules, for all types of financial institutions and markets were either issued or better coordinated by distinct independent agencies at the euro level. Only recently the Financial Services Action Plan mapped out a first set of improvements to the EU legislative framework for securities markets.[121] Meanwhile the *Committee of Wise Men on the Regulation of European Securities Markets* released a final report indicating a four-step approach to making im-

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116. *See* Financial Services Authority, *at* http://www.fsa.gov.uk (last visited Feb. 24, 2003).

117. *See, e.g.,* INSTITUTIONAL ARRANGEMENTS, *supra* note 8, at 17–20.

118. *Id.* at 6–7, 23.

119. Comitology refers to the delegation of implementing powers by the Council to the Commission for the execution of EU legislation — representatives of member states, acting through committees called "Comitology Committees," assist the Commission's execution of its conferred implementing powers. *See* LAMFALUSSY REPORT, *supra* note 8, at 24.

120. *See generally* White, *International Regulation*, *supra* note 34, at 207; John C. Coffee, Jr., *Competition Versus Consolidation: The Significance of Organizational Structure in Financial and Securities Regulation,* 50 BUS. LAW. 447 (1994). *See also, e.g.,* KAREL LANNOO, EU SECURITIES MARKET REGULATION: ADAPTING TO THE NEEDS OF A SINGLE CAPITAL MARKET — REPORT OF A CEPS TASK FORCE 34–35 (2001).

121. Financial Services: Implementing the Framework for Financial Markets: Action Plan, COM(1999)232 final (Nov. 1999).

provements in the EU regulation of securities markets that was approved by the European Parliament in February 2002.[122]

IV. CONCLUSION

This Article argues that financial market regulation should be redesigned and harmonized in the euro area according to a regulatory model "by objectives" or "finalities." This calls for assigning all supervisory powers and regulatory responsibilities in financial markets and intermediaries to a limited number of distinct and independent agencies, regardless of their titles as insurance companies, banks, or investment firms. These agencies should be in charge, respectively, of microeconomic stability, investor protection, and competition safeguards in the financial sector. They should cooperate with the central bank for the purpose of guaranteeing macroeconomic stability and financial soundness.

Two new European financial regulation agencies should be established in the euro area, each formally separated by the ECB. These agencies should be responsible for the comprehensive coordination of both legislation and execution of regulation in financial markets: the first ECA should be responsible for the microeconomic stability of all intermediaries; the second for transparency and disclosure requirements; guaranteeing competition in financial and non-financial markets is already safeguarded by having the Antitrust General Direction of the European Commission, as well as the national agencies. It would be wise to transform the "EU Antitrust General Direction" into a central and independent European agency. The latter and the two newly created central agencies would be at the center of three European Systems of Financial Regulators, each one structured similarly and working in connection to the ESCB

122. LAMFALUSSY REPORT, *supra* note 8 (Adopting a broad framework principles: implementation of these principles through a new EU Securities Committee; implementation of Community law by Member States within the framework of strengthened cooperation and networking between national regulators; establishing a European Committee of Securities Regulators; and urging stronger work by the EU Commission to ensure open and fair competition in the European financial markets.) *See also* Financial Markets: Commission Welcomes Parliament's Agreement on Lamfalussy Proposals for Reform, Feb. 5, 2002, *available at* http://europa.eu.int/comm/internal_market/en/finances/general/02-195.htm.

thereby requiring active participation of national agencies in member countries. This setup is essential for maintenance of regulation and supervision at both the European and national levels in this proposed federal regulatory system. If this "four-peak" regulatory model "by objective" leads to an excess of bureaucracy and poses serious coordination problems in the euro area, as well as in each member country, a more practical solution would call for merging the authorities responsible for microeconomic stability and for investor protection into a single agency, following the U.K.'s FSA example. The conflict of interest ensuing in these two objectives is surely less significant than that between stability and efficiency.

Many difficulties are obvious in this proposal. Even in case of a consensus on the final architecture for financial market regulation, it is difficult to design and follow a feasible political and institutional plan to build it. Changes in the Maastricht Treaty are needed in order to establish new agencies.[123] These can be proposed only at the next intergovernmental conference and not before 2004. Changes in the national legislation of each EU member country are also needed, and providing a satisfactory degree of accountability for the new agencies will be a difficult task. Moreover, there most likely will be strong political and institutional opposition to such reforms. To be sure, full financial market integration will require a much higher degree of political integration in Europe.

The authors maintain that there is an observable movement towards a financial regulatory scheme similar to the proposed "four-peak" architecture. With regards to macrostability and competition, there is already an incomplete federal system in place. For investor protection and business conduct, the new committees established in the wake of the Lamfalussy Report have started to coordinate and guide the national securities regulators.[124] The present challenge deals with prudential supervision and microstability of all financial intermediaries. Given the consolidated experience of the Basle Committee on Banking Supervision and the recent experiment of the ESCB and the forum of European Securities Commissions ("CESR"), it

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123. MAASTRICHT TREATY: TREATY ON EUROPEAN UNION, Feb. 7, 1992, O.J. (C 191) 1 (1992), 31 I.L.M. 253.

124. *See generally* LAMFALUSSY REPORT, *supra* note 9. *See also European Securities Regulation: Trojan Horses*, ECONOMIST, Feb. 15, 2003, at 67–80.

seems plausible to believe that a new framework for European financial market regulation and supervision will emerge based on EU-level harmonized (secondary) regulation as well as national supervision.

TABLES AND GRAPHS

Figure 1: Current Assignment of Responsibilities for Supervision in Banking, Securities, and Insurance Markets in the EU†

Country	**Banking**	**Securities**	**Insurance**
Austria	U	U	U
Belgium	BS	BS	I
Denmark	U	U	U
Finland	BS	BS	I
France*	CB,B	B,S	I
Germany	U	U	U
Greece	CB	S	G
Ireland	CB,U	CB,U	CB,U
Italy	CB**	CB, S	I
Luxembourg	BS	BS	I
Netherlands	CB,S	CB,S	I,S
Portugal	CB	S	I
Spain	CB	S	G
Sweden	U	U	U
United Kingdom	U	U	U

Key to Figure 1:

CB: Central Bank
BS: Banking and Securities Supervisor
B: Banking Supervisor
S: Securities Supervisor
I: Insurance Supervisor
G: Government Department
U: Single Financial Supervisor

† *Sources*: ECB, MONTHLY BULLETIN (Apr. 2000), *available at* http://www.ecb.int/pub/pdf/mb200004en.pdf; KAREL LANNOO, CENTRE FOR EUROPEAN POLICY STUDIES, CHALLENGES TO THE STRUCTURAL SUPERVISION IN THE EU 34 (2000).

* Project announced to introduce a single financial supervisor.

** In Italy the Central bank is also the authority responsible for antitrust in the banking sector.

Figure 2: A Four-peak Regulatory Model by "Objectives" for the Financial Sector

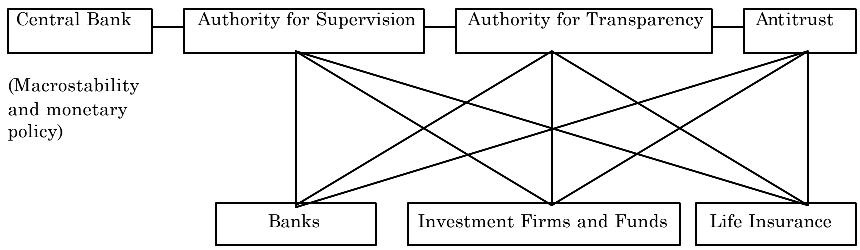

Figure 3: The European System of Financial Regulation