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Evaluating the European management of the financial crisis : Which regulatory and supervisory model should be adopted?

1 - Prudential organization in the European Union facing integration and the crisis

The present financial crisis strikingly lays stress on the inconsistency between the growing financial integration through the EU and the decentralized organisation of the supervision, while a single currency has been adopted by most of the EU members. Proposals for reforms of the Regulatory and Supervisory system, recently made by the Commission, will probably be adopted in June, in order to provide the EU with a more integrated or coordinated system.

The aim of this paper is to recall the specific process of integration in the EU, to evaluate the crisis management in the EU and to discuss the proposals for reforms. Moreover, it deals with the lessons that should be drawn from that crisis management regarding prudential doctrines and especially that of the Lender of Last Resort.

When they launched the euro, EU decision-makers undertook giving a strong impulse towards EU financial integration, with two Financial Services Action Programmes (FSAP, 1999-2004 ; 2005-2010 [Commission, 2005].) Those ambitious plans, which can only be compared with the 1986 Single Act plan, aimed to improve the single market of financial services, in order to promote growth and employment. Regarding this process, a kind of reciprocal "spill over effect" can be observed : on the one hand, the Single Act directly led to the euro, on the basis of arguments drawn from R. Mundell's thesis [1961] ; and on the other, the creation of the single currency gave a strong incentive to complete the single market.

From the outset, the single market of financial services in the EU was built according to a very genuine policy. Indeed, this process comprises several strong features such as : i, the definition of a statute for each of the financial sectors (banking, insurance, securities…) ; ii, all the institutions are subject to the EU regulations ; iii, a programme of liberalisation, according to a well known trilogy (free movement of capital, freedom to provide services and freedom of establishment) and based on two principles, the EU passport and control by the home country ; and, iv, the elaboration of a set of harmonized rules, especially prudential ones, aimed at avoiding regulatory competition and to ensure financial stability.

Such a programme should ensure, according to the leitmotiv of the EU Commission leaders (partly influenced by P. Krugman's contributions in the eighties), increased efficiency in the financial system owing to the competition and the economies of scale provided by the opening of national markets and the consolidation of the financial actors [e. g. see Commisssion, 2009-1].

Despite the plethora of EU directives for over thirty years (more than forty directive for insurance companies, for instance) and the two recent FSAP, experts agree about the weak integration on the retail markets of financial services. These remain mostly national ones, freedom to provide services and freedom of establishment have had little effect so far, chiefly because of national rules on consumer protection and the lack of tax harmonization, as the experts reports on the 1st FASP, as well as the European Banking Federation or the Commission put it [see COM (2007) 33 final].) Improvements on retail market integration should be obtained by the implementation of two important directives, on financial instruments (MiDIF, 2004) and the Single European Payment Area (SEPA, 2007.)

On the contrary, with the convergent impacts of the Single currency, the two FASPs and the general context of economic liberalisation through the world, a quick movement towards financial integration could be observed in Europe, first on monetary markets, then, with some disparities, on bond markets and on wholesale financial services markets. Next, integration grew on markets infrastructures and cross-border mergers were concluded [(European Central Bank (ECB),2009-3; Commission, 2009-1 ; High Level Group report, 2009, p. 71]

In the European Union, ten years after the launching of the euro, the policy that should be pursued with regard to the supervision and management of the financial crisis still remains an issue of debate. Regarding this question, which was discussed even before the creation of the single currency [Goodhart and Shoenmaker, 1995], supporters of a centralized scheme [Aglietta, 1999] are in strong opposition with the followers of the decentralized status quo, mainly among National central banks of the Euro area. The latter advocate the skillfulness of national supervisors, given their intimate knowledge of national financial actors [Perrut, 2005.]

Since 2001, several reforms have been made to enhance coordination and convergence of the EU supervision, chiefly the so-called Lamfalussy process of comitology *(see hereafter, part 2)*, instigated by the European Council.

A review of the current arrangements on supervision, especially on comitology, took place in 2007. The development of the financial crisis made such a reform even more urgent. A High Level Group on financial supervision in the EU (HLG), set up in October 2008 by the EU Commission, published proposals for a reform by february 2009 [HLG, 2009.] Mostly agreed by the EU Commission, those proposals will probably lead to decisions by the June European Council.

The question we have now to deal with is whether those proposals can prevent a further crisis or ensure efficient management when such a crisis occurs. By way of a response, this paper will examine :

- first, the management of the crisis by EU institutions ;
- second, the chief criticisms made to the current organisation and the proposals for reforms ;
- third, we shall discuss : the problems raised by the crisis management with regard to the doctrine and the strengths and weaknesses of the proposals for institutional reforms.

2 – UE institutions and the crisis management : intergovernmental and communitary action

The management of the present crisis in the EU was led with the commitment of several institutional bodies :

- decisions taken by intergovernmental meetings (European Council, Ecofin, Eurogroup), in coordination with international meetings (mostly G7 and G20) ;
- legislative or regulatory actions from the institutional community "triangle" (European parliament, Ecofin, Commission) ;
- Eurosystem actions, mostly aimed at providing banks with liquidity.

21 - Coordination between Governments and State programmes

In order to improve the management of financial crisis, the Ecofin council published, October 2007, a general roadmap. Next, in order to face the worsening financial situation, September 2008, several intergovernmental meetings were held, chiefly Ecofin (October 7th) and Eurogroup (October 12th), in order to prepare the mid-October European Council (EC), concluded by strong commitments : supporting the major financial institutions, avoiding bankruptcies and protecting savers' deposits ; ensuring, in conjunction with the Central Banks, sufficient liquidity for financial institutions ; providing them with capital resources and facilitating their funding ; requiring rigorous implementation by financial institutions of recommendation on the transparency of their commitments and risks [E.C., 2008.]

Next, EU governments took prompt measures to support banks :

- the opening of guarantee schemes in favour of banks, aimed at supporting lending to the economies ;
- recapitalisations, with several tools, in order to rescue financial institutions in difficulty : nationalisation de facto in England (Northern Rock, RBS) ; subordinated loans in France ;
- rescuing of cross-border institutions by international coordination of state members (Dexia, Fortis) ;
- setting-up defeasance structures ("bad banks") ; this tool has not been used much so far in the EU, except in Germany and Spain.

Finally, the financial commitment of the six major EU member states could reach the following figures (at the end of 2008) : guarantee schemes, 970 billion euros (B€), bank recapitalizations : 101 to 181 B€ ; deafeasance structure : 50 to 130 B€ (depending on whether German policy, whose amount should arise 80 B€, would prefer recapitalization or "bad bank" solutions.

It is tempting, indeed, to add up those impressive amounts as percentages of EU GDP (e.g. 15 % of the EU GDP, according to a CEPS report [2008, p. 17.]) However, new capital given to banks cannot be compared with the opening of guarantee lines, that may never be used and concerning which, if used, the probability of default could be rather weak.

The choice about the tools is being left to each Member State. Nevertheless, a common set of principles to coordinate national stabilisation measures in the area of bank recapitalisation and funding, has been defined by the Commission and the ECB, each following its own function. The Commission, as the caretaker of the competition rules must prevent distorsions in the level-playing field in the Single market. As for the ECB, it aims at ensuring the consistency of national plans with the management of liquidity by the Eurosystem [ECB, 2009-3.]

22 - Communitary institutions : emergency legislative and regulatory actions

Following the impulse of last autumn's intergovernmental summits, **the EU legislative institutions** took several emergency measures and are committed to taking a new range of decisions soon. Those legislative instruments mainly focus on :

- October 2008 ; amendments about international accounting standards (IFRS), allowing : - a new classification of financial instruments in order to limit the impact of wide stock markets fluctuations on banks balance-sheets ; - using model-based valuations (mark-to-model) of financial instruments whenever a valid market reference no longer exists ; these changes are aimed at avoiding disavantages for EU institutions by comparison with North-American ones ;
- October 2008 ; tightening up the rules on the bank deposit guarantee scheme, in order to improve confidence in the banking sector : the minimum level of deposit protection is

increased without delay to 50.000 € (instead of 20.000 €), and to 100.000 € one year later ;

- October 2008 ; first revision of the 2006 Capital requirement directive (CRD, the purpose of which is the universal transposition in the EU of the Basel II framework, aimed at defining a new set for banking capital requirement) ; a new proposal is expected in June 2009, coordinated with the Basel Committee on Banking Supervision (BCBS) programme, aimed at reinforcing capital requirements both for trading book activities and for complex securitization [BCBS, 2009-1 & 2] ;
- legislative proposals establishing regulatory and supervisory standards for hedge funds, private equity and other market players of systemic importance (expected in 2009, April);
- legislative proposal (expected during autumn 2009) on liquidity risk and excessive leverage, coordinated with Basel Committee work.

The EU Commission, in addition, adopted or foresaw several measures :

- decisions (January 2009) aimed at enlarging and strengthening the Level 3 committees (*see below* [Commission, C(2009) 176 to 178 final]) ;
- publication of guidelines about the treatment of impaired banking assets (February 2009, 25th) ; obviously, the fear of facing a "ghost bank" problem, as could be observed during the longlasting japanese crisis [F. Mishkin, 2008], is shared throughout the EU ;
- a paper to be published in june 2009, to deal with tools for early intervention to prevent a crisis.

23 - Eurosystem policy

Facing a general liquidity shortage on the interbank markets (in 2008, all year long, the spread between the main ECB key rate for refinancing and the 3 month Euribor interest rate exceeded 100 base point), the Eurosystem took charge of providing banks with liquidity. The ECB Governing Council defined, at the beginning of October, a new set of measures in order to ensure better conditions for the refinancing of banks :

- fixed rate tenders in euros with full allotment for open market operations ;

- longer-term loans for refinancing operations ;
- expansion of the list of collateral in the Eurosystem credit operations :
    - lowering of the credit threshold for most of marketable and non-martetable assets from A- to BBB- ;
    - eligibility of debt instruments, including certificates of deposits and subordinated instruments, under certain conditions ;
    - careful valuation of the assets with separate adding-up of each risk (rating, exchange risk, maturity) ;
- swap lines with non euro central banks (without limitation with the Fed) ;
- decisions to lower progressively the key ECB interest rates.

Finally, the average amount of liquidity the Eurosystem provided to banks, through open market operations, reached 750 to 850 billion euros (B€) during the last quarter of 2008, against about 450 B€ from the beginning of 2007. Consequently, the consolidated balance-sheet of the Eurosystem almost doubled, reaching a total amount of 2.075 B€ at the end of 2008, against 1.150 B€ at the end of 2006.

3 - The regulatory and supervisory system of the EU : criticisms and proposals for a reform

31 - Criticisms of the EU system

Despite numerous measures taken since 2001, leading to a real improvement, serious shortcomings can be observed in the regulatory and supervisory system of the EU. Those weaknesses can be summarised in the following points.

Failures in the legislative process. Legislative institutions did allow, in their directives, too much scope for interpretation by the State members in the process of implementation in the different national legal systems. Therefore, national systems throughout Europe lack consistency [HLG, 2009, n° 102, p. 27.] Moreover, directives failed to foresee delegatory powers in order to ensure that level 2 could fully comply with its mandate [ECB, 2008, n° 2.2.]

Regulatory inconsistencies among the EU countries. Many regulatory disparities can be observed from one Member State to another. For instance : in the very definition of credit intitutions ; in reporting obligations ; in the definition of "core capital" for banks, and on the treatment of subordinated debt in this respect ; in the calculation of technical provisions for insurance companies ; in the modalities related to deposit insurance and insurance guarantee schemes. Last but not least, "there is no single agreed methodology to validate risks assessments by financial financial institutions" [HLG, 2009, n° 105, p. 28.]

Failures in detection. There is general agreement in acknowledging that the financial risks have been strongly underestimated, especially in the EU, by market actors (rating agencies, for instance) as well as by authorities. As the HLG put it, EU supervisors "failed to spot the degree to which a number of EU Financial institutions had accumulated... exceptionally high exposure to highly complex... financial assets" [HGL, 2009, n°27, p. 10.]

Role of the Committees of national supervisors (Level 3 Lamfalussy Committees) In 2001, with a mandate from the European Council, a group headed by A. Lamfalussy published an extremely severe report about the legislative process in the EU, leading to recommendations and to a legislative reform for the three financial businesses (securities, banking and insurance) establishing chiefly :

- Three Regulatory committees (level 2), comprising representatives of member states to contribute to better regulation ;
- Three Committees of national supervisors (Level 3 : Committee of European Banking Supervisors, CEBS ; Committee of European Securities Regulators, CESR ; Committee of European Insurance and Occupational Pensions Supervisors, CEIOPS), to ensure a constant and timely implementation of legislative measures at the national level. Those committees have to work in relation with supervisory colleges, whose task is to control EU cross-border banking groups *(see below.)* To take an example, the Committee of European Banking Supervisors is comprised of high level representatives from banking supervisory authorities and central banks of the EU.

Following the Himalaya report [2004], by one of the Level 3 committees (the CESR), a global review of the Lamfalussy process took place during the Ecofin Council (December 2007), with, inter alia, inputs from the Commission, the Eurosystem and the European Banking Federation. This review was followed by decisions from the Commission (January 2009) to strengthen level 3 committees, as mentioned before. Stronger incentives on the national supervisors, with the so-called "comply or explain approach" (when a national supervisor refuses to comply with a recommendation from the committee, an explanation must be given) is expected from these measures. In addition, Ecofin invited the State members to introduce a European dimension into the mandate of their national supervisors by mid-2009.

In spite of their recent strengthening, Level 3 Committees still suffer from many shortcomings related to : i, their non-binding mandate [HLG, 2009] ; ii, the high number of their members ; iii, the lack of a clear basis to perform their duties [ECB, 2008] ; iv, the decision-taking problems (mostly by consensus.) Given this context, the Level 3 Committees mainly acted as "an informal mediator" and their mandate, recently expanded, has become somewhat unfeasible [CEPS, 2009, 19] and not really clear, according to the very text of the Commission's decisions.

Supervisory colleges were set up in order to ensure effective coordination of the supervision of cross-border banking groups. These colleges work with level 3 committees. Each college is chaired by the home supervisor of the group's parent and made up of authorities from all the countries in which the group owns subsidiaries or branches. The function of the colleges was clarified by the 2006 CRD Directive (2006/48/EC) and its revision (October 2008.)

Regarding the ability of these colleges to fulfil their responsibilites, several problems must be mentionned : i, the disparities between the national statutes of their members ; ii, the doubtful willingness of the supervisors as to sharing information (as could be observed during the rescue of Fortis, in september 2008) ; iii, the tricky relations between home and host supervisors. In addition, the question must be raised as to whether the information gathered by the 123 existing colleges is really amalgamated at the European level [HLG, 2009 ; CEPS, 2008.]

The Memoranda of understanding (MoU) provide the supervisory system with a legal basis for cooperation between treasuries, central banks and supervisors in crisis situations. A frame for those MoU was initially written by the ECB in 2003 and then upgraded several times before 2008. However, those agreements are not legally binding and, as they comprise many authorities, they can hardly be considered as effective bodies. Moereover, the criteria for burden-sharing between the Member States facing a cross-border crisis should be clarified [HLG, p. 37].

By way of conclusion, it can be asserted, beyond any doubt, that the supervisory and regulatory system in the EU is complex and fragmented between many Committees and Colleges : 7 Lamfalussy Committees ; about 15 in the European System of Central Banks (ESCB) among which the Banking supervision committee is committed with supervisory tasks at macro-prudential level ; the 123 supervisory colleges, as mentioned before ; the Financial Services Committee (which brings together national treasuries) and the Economic and Financial Committee (which gathers together representatives of the treasuries and the Central banks.)

The definition of the functions of those bodies often lacks clarity. Legal powers do not appear to fit with the duties. Therefore overlapping can be observed between the committees, either because of the confusion in the statutes, or because of the missions requested by the authorities, sometimes unsuitable for their functions.

Regarding the organization of the EU's supervisory system, the point of view of the Commission is quite clear : "One of the major lessons of the crisis was that when it came to the crunch, cross-border supervisory cooperation was ineffective and unresponsive. The EU's supervisory system has failed to adjust to the complexity, internationalisation and inter-linkages of financial markets." [Commission, 2009-2, Annex, p. 2.]

This plethoric, complex and somewhat confuse supervisory system probably appears as the result of the recurrent tension between "pros" and "cons" towards the needs of enhancing the centralization of the supervision, as well in the ESCB as in the governments.

32 - The proposals for reform

In its mandate given by the Commission, in october 2008, the High Level Group is "requested to make proposals to strengthen European supervisory arrangements covering all financial sectors, with the objective to establish a more efficient, integrated and sustainable European system of supervision" [HLG report, 2009.]

Among its numerous recommendations (no less than 31), the group make propositions for a reform of the supervisory system. It advises a clear separation between the macro-prudential level, entrusted de facto to the ECB and the ESCB, and the micro-prudential level which should remain independent from the ESCB. The reform of the micro-prudential level would mainly consist of an enhancement of the present Level 3 committees of supervisors.

Regarding the **macro-supervision** the Group recommends the creation of a new body called **European Systemic Risk Council** (ESRC) working with the infrastructure of the ECB, chaired by its President and comprising [HLG, 2009, p. 46] :

- members of the General Council of the ECB (which brings together all the Presidents of the EU national central banks) ;
- the chairpersons of the 3 supervisory Committees (CEBS, CEIOPS, CESR) ;
- a representative of the EU Commission.

The tasks of this body should mainly be :

- to "pool and analyse all information, relevant for financial stability, pertaining to macro-economic conditions and to macro-prudential developments in all financial sectors" ;
- to share this information with national supervisors ;
- if a potential systemic risk is detected, to set up a warning system (in cooperation with the Economic and Financial Committee and the Commission), in order to implement a proper strategy ; if necessary, the ESRC would warn the international authorities (IMF, FSF, BIS.)

Regarding the **micro-supervision,** the Group recommends the creation of a European System of Financial Supervisors (ESFS), working as a decentralized network, independent of the political authorities, but accountable to them. According to the subsidiarity principle, the system would be organised in the following way [HLG, 2009, p. 48]:

- "existing national supervisors would continue to carry-out day-to-day supervision ;
- three new European Authorities would be set up, replacing CEBS, CEIOPS and CESR, with the role of coordinating the application of supervisory standards and guaranteeing strong cooperation between the national supervisors ;
- colleges of supervisors would be set up for all major cross-border institutions."

In April, a communication by the Commission, in order to prepare the Ecofin council and the European council of June, made legislative proposals *(see part 2)* and follows closely the main lines of the HLG's recommendations in order to reorganize the EU's supervision [Commission, 2009.]

Thus, in a "European financial supervision package" to be published by the end of May 2009, the Commission will make proposals for a new "Supervisory framework that detects potential risks early, deals with them effectively… and meets the challenge of complex international financial markets". These proposals will comprise two parts :

- "Regarding macro-prudential supervision, measures to establish a European body to oversee the stability of the financial system as a whole" ;
- "Regarding micro-prudential supervision, proposals on the architecture of a European financial supervision system".

4 - Evaluating the crisis management in the EU and the proposals for reforms

41 - About the Lender of Last Resort (LLR) and the Moral Hazard : a few questions

The evolution of the doctrine

The classical model of the LLR, established originally by H. Thornton [1802] and then by W. Bagehot [1873], was based on a clear separation between problems of illiquidity and insolvency when a crisis occurs in a financial institution. This model recommended that central banks rescue banks facing liquidity problems but that banks with an insolvency problem should not be saved. In addition, the rules for the intervention of the LLR were to be clearly announced before the crisis [Humphrey, 1989.] This classical model dealt mostly with the policy of the Central Banks.

At the end of the 19th century, this model was an undiscussed reference for Central banking policy, especially for the bank of England.

However, its principles meet serious problems when put into practice. First, how are illiquidity and insolvency problems to be clearly distinguished ? As a matter of fact, during a financial crisis the lowering of asset prices can turn an illiquidity crisis for an institution into one of insolvency. Second, how could the central banks give a clear information about their policy before the crisis, according to the theory principles, without creating a strong moral hazard situation.

Moreover, with the movement of mergers among financial institutions throughout the 20th century, many banks have reached such a size that their failure would threaten the whole system. Therefore, the failure of such institutions must be avoided, even in insolvency situations. Hence the formula "too big to fail" (TBTF) has been used to qualify those banks.

A huge moral hazard problem is thus created for important banks. As they know they are TBTF, they may be tempted to pursue risky strategies, being sure they will be rescued by the LLR if a distress situation occurs.

In order to limit the probability of crisis situations compelling the LLR to intervene and thus leading to perverse consequences, a different doctrine was progressively defined. We call this doctrine "the hierarchical prudential model". This organization has today gained consensus throughout the world. This system aims at avoiding the moral hazard situations linked to the rescue of TBTF banks. Therefore, a hierarchical organization is set up, under the responsibility of the central bank (or under its delegation) to protect the LLR function, leading to the creation of two safety nets :

- guarantee deposit schemes (and in some financial centers interbank agreements for mutual help) ;
- supervision, comprising prudential rules (as Basel II framework, for instance) and surveillance of banks, either by the central bank or by a supervisor.

As E.P.M. Gardener summarize it in a striking formula : "At one level, supervision can be seen as a process of ensuring that the central bank lender of last resort is not used as a 'lender of first resort' [1992.]" Moreover, in this doctrine, the LLR remains unclear as to its policy, in order to contain moral hazard ; this principle is called "constructive ambiguity".

For about 20 years supervision has been partly elaborated by the Basel Committee on Banking supervision (BCBS), a coordination of major central banks. However, the implementation of the BCBS rules and the definition of additional standards widely differs from one country or area to another. Several models in the architecture of the supervision can be observed : "meta-regulation" in the UK with the creation of the Financial

Services Authority in 1997, while a "twin peak" model (with a distinction between prudential supervision and market supervision) was adopted in Australia and in France.

In the EU, the set of prudential rules is harmonized and binding for all the financial institutions subject to the EU's legislation. This represents a real strength for the safety of the single market of financial services.

In the present crisis, the LLR functions are shared between Central banks and States

Obviously, the "safety nets" provided especially by the supervision were not able to contain the occurrence of the present crisis. Consequently, we can observe that during the recent banking crisis (since the mid-eighties), the States were obliged to rescue even insolvent institutions, if they were of systemic importance.

In the present crisis a new phenomenon appeared : the coordinated involvement, by all the major States, at the international (G7, 11 October 2008) and at the EU's level (Eurogroup and European Council, mid-October 2008), by all the major States to rescue all the systemic institutions.

The functions of the LLR were then shared between the States and the Central banks :

- on the one hand, the States took responsibility for recapitalising the banks in difficulty (until nationalization, if necessary), for setting up guarantee schemes to the banking system and for the management of impaired assets (mostly through the creation of "bad banks") ;
- on the other, Central banks provided banks with unlimited access to liquidity.

The Eurosystem function : a market maker of last resort more than a LLR

The Eurosystem action mainly consisted in ensuring banking liquidity through loans guaranteed by collateral which had become illiquid. Therefore, the Eurosystem operated a substitution of its action to that of the interbank market, enduring a situation of illiquidity. Thus, the Eurosystem function during the crisis was that of a market maker of last resort, more than a LLR one [J.-P. Pollin, 2008.]

This policy raises the question of the consequences of the expansion of the list of collateral eligible by the Eurosystem. Did the lowering of the credit threshold have consequences on the quality of the balance-sheet of the Eurosystem ? The answer is closely related to the method used for evaluating the assets accepted as collateral.

What about the independence of the central banks ?

A prolific literature established in the eighties the need for central banks to be independent from the governments in order to ensure their credibility, mostly regarding monetary policy.

During the present crisis, central bank actions are realized in coordination with the States. In many cases, the latter took control of major financial institutions, while central banks or supervisors are involved in the control of those institutions. Thus the question of the independence of the central banks must be reconsidered.

The crisis management and the moral hazard

Two consequences result from the coordinated involvement of States to prevent failures of important institutions : firstly, it creates ipso facto a moral hazard problem ; secondly, it leads to an even more concentrated financial sector, given the bail-outs or the mergers organized by the public authorities, and consequently to a worsened TBTF problem.

Therefore, how are we to deal with this huge moral hazard problem resulting from the commitment of the public sector ? Is it realistic to enforce a new Glass-Steagall Act (with geographic limitations and a strict separation between commercial and investment banks) ? How to define a more binding-frame for the managers (controlling their earnings and incentives ; hardening the repression of the abuses) ? Should the Authorities expand the regulation on all the financial actors (according to the EU's policy ; the new EU's legislative proposals on hedge funds and private equity firms, for instance, aims at ensuring the financial stability and avoiding regulatory competition) ?

42 - The EU's proposals for reforms in the supervisory system

Detection defaults in the EU. Severe defaults have been established in the EU, regarding the ability of the Authorities to detect and to prevent problems.

With some reason, all the actors, public or private, have been criticized : national supervisors, supervisory committees (level 3), ECB committees, rating agencies, the accounting standards of the IASB (whose main principle is the Full fair market value), financial institutions, unable to publish a reliable estimate of their losses. Regarding the latter, the global estimated losses in the financial sector have been multiplied by 10 since the beginning of the crisis (according to IMF data, the entire losses could amount to 4.000 billion $ at the end of 2008 [IMF, 2009].)

Complex financial instruments such as securitized assets, (RMBSs), structured assets (CDOs, often including credit or insurance derivatives, CDSs), are difficult to valuate when a crisis occurs.

As soon as the first signs of problems of liquidity or insolvency on such instruments were apparent (failure of 2 hedge funds belonging to Bear and Stearn and information from BNP Paribas about its inability to estimate its funds any more, in July-August 2007), the operations on the world interbank markets suddenly stopped.

The valuation of complex securitized instruments, especially structured ones, creates a problem of circularity between three terms : valuation, market value, liquidity. Valuation is not possible without a market value reference in order to establish the fair value requested by accounting standards (IFRS) ; but the market value cannot be established without liquidity ; liquidity itself depends on valuation [L. Clerc, 2008.] Detection defaults are thus closely linked with problems connected with valuation.

Macro-supervision. The Eurosystem's huge loans aimed at resolving the interbank liquidity shortage led to an increase in the potential risk in its balance-sheet. The ECB request a centralized system of information, given the fact it could suffer losses if a counterpart bank encounters a solvency problem. Hence, the "need for timely and exhaustive transmission of supervisory information at the European level" [L. Bini-Smaghi, quoted by CEPS, 2009, p. 24.]

Since the creation of the ESCB, the Ecofin Council seems reluctant to support such a centralization. The proposal of reform by the HLG and the Commission aimed at setting up a ESRC seems necessary. As to the satute of the ECB, there is no need to instigate a process of reviewing the Maastricht treaty in order to implement, as far as we know, such an organizational change.

Micro-supervision.

Several conditions are requested to ensure effective coordination in the EU's supervisory organization. As for the Level 3 committees (which would be upgraded later as Authorities), it appears indispensable to implement several changes :

- making clear the legal basis of their action ;
- giving those committees binding functions ;

- establishing a roadmap (with the clear purpose of ensuring a convergence in supervision) ;
- reforming the decision-making (with qualified majority voting)

Regarding the composition of those commitees, it may be asked whether they comprise too many members. Decreasing their number could help them to work more effectively. By way of comparison, the Lisbon Treaty (December 2007) established a diminution in the number of the members of the EU Commission by 2014. Such an evolution for the committees might be the political cost (each Member State would not have a representative in that case) in order to achieve effective structures.

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