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INTERNATIONAL CO-OPERATION BETWEEN FINANCIAL SUPERVISORS, POSSIBLE WAYS FORWARD

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1. RESEARCH BACKGROUND AND OBJECTIVES

1.1 Research background

Hungary, as member of the European Union has become a part of a well-organized and developed financial system. The domestic financial supervisory authority (HFSA and later MNB) has to face with much more sophisticated requirements and expectations then before. The requirements of the European Union are mainly based on the principle of an integrated financial market, which requires a harmonized regulation and a convergence in the methods of financial supervisory activity.

The requirements of the European Union are mainly present in the following activities:

a) MNB is present at the EU working groups and committees, which are responsible for developing new EU directives and regulations, or to modify current legislation, therefore MNB may have a direct influence on the future regulatory framework,

b) MNB has the right to issue supervisory decrees and to make suggestions to modify domestic legislation, and is actively involved in preparation of Hungarian laws, Government decrees, therefore MNB has a substantial role in the implementation of EU legislation in Hungary,

c) MNB prepares its own internal regulation and methodologies based on the standards prepared and issued by EU supervisory authorities (EBA, ESMA, EIOPA, ESRB),

d) MNB is responsible for licensing the establishment of credit institutions, and this license gives the possibility for domestic credit institutions to provide cross-border financial services or to establish branches in other EU Member States (based on the principles of internal market and passporting),

e) MNB is the member of the European System of Financial Supervision (ESFS), which gives a special role to MNB regarding the supervision of cross-border financial groups on a consolidated basis and common decisions.

The system of an integrated internal market makes necessary for the financial supervisory authorities of Member States to closely co-operate in the preparation of the legislative basis and also in the daily supervisory activity. According to the Lamfalussy procedure, which originally belonged only to the capital market, but has been activated for banking and insurance supervision as well, the supervisory structure has been already formulated, with the aim to strengthen the regulatory and supervisory convergence in the Member States. This kind of convergence procedure is explicitly required by the Capital Requirements Directive (CRD) and Capital Requirements Regulation (CRR), which are meant to implement the Basel III guideline, issued by the Basel Committee for Banking Supervision on a European level.

The main aim of the regulatory and supervisory convergence is the better co-operation between financial supervisors and the integration of regulation and supervision. The establishment of the banking union, and especially the nomination of the European Central Bank as a Single Supervisor of the most important credit institutions in banking union countries, has been an important step to achieve this goal. This convergence procedure on a longer terms may lead to an establishment of a single and integrated supervisor for all financial sectors, including banking, capital market and insurance. Although currently there are many obstacles to set up such a supervisory body (for example the differences in supervisory structures, as in some member countries the sectoral supervisory authorities are integrated, in others are separated), but on a longer term these procedure may lead to a fully integrated, single supervisory mechanism in the European Union.

However, other challenges exist for the Hungarian financial supervisor, as there are some credit institutions in Hungary, which are subsidiaries of a non-European bank. While EU directives are quite short-spoken about the co-operation with financial supervisors from third countries, this kind of co-operation may not be neglected, as these subsidiaries are handling large amounts of deposits and investments of their clients. In order to ensure the safety of these funds, MNB must establish well developed co-operation agreements with third country financial supervisors as well.

The legislative framework for the activity of credit institutions is a significant and well-emphasized part of the internal regulation of the EU. The first attempts to create a common legislative framework are dated back to the 70s. The current legislative framework contains not only the basic rules, but gives a very detailed system of requirements, which are not only implemented in laws but also in Ministry of Finance or supervisory decrees. More and more requirements are regulated by EU Commission Regulations, which are directly enforceable in Member States, and there is no need to issue a national regulation to implement the EU requirements.

Although it is clear that the EU legislative framework for credit institutions is quite substantial, but there are still many differences at national level in the regulation and supervisory methods of Member States. As an important step towards a more integrated financial market, the European Union according to the Lamfalussy procedure[1] has firstly created the so called Level 3 Committees (CEBS, CESR, CEIOPS, which were later transformed into the ESAs). These Committees were aimed to be the most appropriate form to develop new legislative and methodology proposals in the area of financial and capital markets. These proposals and methodologies, may be based on existing

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[1] FINAL REPORT OF THE COMMITTEE OF WISE MEN ON THE REGULATION OF EUROPEAN SECURITIES MARKETS, Brussels, 15 February 2001, http://ec.europa.eu/internal_market/securities/docs/lamfalussy/wisemen/final-report-wise-men_en.pdf

directives and can be used by all supervisory authorities in the Member States. Another important step was to give a higher importance and more weight for the directly enforceable regulations, which give much less room for Member States for divergent procedures. The convergence procedure in the internal market covers not only the legislative framework, but also the supervisory methodology.

Currently, the EU internal financial market is mainly dominated by complex cross-border financial groups, the activity of which covers banking, investment, insurance and pension services, and are actively present in many Member State at the same time. Such complex financial groups required the review of the co-operation between national financial supervisors. This has a clear importance not only at EU level, but also globally, however, the legislative structure of the European Union gives the possibility to create a much more detailed way of co-operation then an a global basis. Even though there is an intention for close co-operation on a global level, the tools and procedure of co-operation is much better developed between EU Member States.

The main aim of this paper is to summarize and overview the evolution of co-operation, to explain the main reasons of the development procedure, how to comply with existing challenges, and how to solve the problems the current system is facing with. The research covers also what this co-operation means in the daily work of MNB and what kind of developments it requires.

1.2 Research objectives and assumptions

The main objective of the dissertation is to overview the development of the system of international co-operation between financial supervisors on a global and European basis, to summarize its current structure, to analyze the main features of the co-operation and to give proposals to improve the current system of co-operation. In order to achieve this aim, the guidelines of the Basel Committee, the legislation of the European Union and the methodology papers and guidelines of the EU institutions, which are responsible for supervisory convergence have been reviewed.

It has been also the aim of the research, that after reviewing and summarizing these documents, and taking into account my personal experience in this field, to summarize the main problems of the current international co-operation system and to give proposals in order to solve the problems. The European System of Financial Supervison is currently in a very fast development process (establishment of ESAs, banking union etc.) and it is clear that this development process has not yet finished. While the most important element of the current reform is the creation of a Single Supervisory Mechanism, there may be even more possibilities to achieve a better functioning co-operation.

There are still many important questions regarding the banking union, especially that how effective answer this can be for the current problems of financial supervision. This question is also relevant as Hungary shall make a decision whether to join the banking union as a non-eurozone country. The research examines what kind of achievements the banking union means compared to the previous supervisory co-operation system, and what kind of challenges it has to face with in order to be a better way of co-operation. One of the main aim of the research is to give concrete proposals whether Hungary should join the banking union and what kind of steps could be taken to strengthen and develop the current framework of the banking union.

Hungary has to take into account many pros and cons when deciding about to join the banking union, in order to take the most adequate decision. This decision will definitely has an effect for the whole economy of the country, as a developed, well-regulated and supervised, safe banking system is an essential condition of economic growth. The research also aims to summarize and analyze these pros and cons.

2. CO-OPERATION BETWEEN EU FINANCIAL SUPERVISORS

The main reason why this issue is actual, that the system of international co-operation of EU financial supervisors is under a very fast development procedure. Groupe de Contact, which was established in 1972, was the most appropriate and suitable forum of supervisory co-operation for 30 years during the financial market conditions of those years. In 2004, when CEBS was established, it was already clear, that this will be only a transitional solution towards an EU supervisory authority. In 2011, with the establishment of EBA, this authority has been given much more power regarding the development of supervisory co-ordination, harmonized legislative framework and supervisory convergence. In 2014, when European Central Bank has been nominated as a single supervisor in EU, it became even more evident, that the supervision of cross-border groups must be taken into account EU level reasons, rather than national level. Even the dates of these steps gives a signal, that the structural changes in the EU supervisory framework has been accelerated, and this is the only way to keep in steps with the innovation and challenges of the financial sectors.

During the research, my 20 years of practice in the field of financial supervision has been used and also my experience as member of several EU working groups and committees[2].

To complete the research I studied the relevant EU directives, regulations, technical standards and the guidelines of CEBS and EBA, which are related to the issue of supervisory co-operation. I also read the relevant guidelines of the Basel Committee. I examined the literature of the topic, also expert views and the speeches of leaders of institutions, which plays an important role in

[2] I was the Hungarian member to Groupe de Contact, EGPR and SCREPol, and also alternate member to EBA Board of Supervisors, between 2011 and 2013.

international supervisory co-operation. I have discussed this subject with many employees of the MNB, who takes part in the daily work of the supervisory colleges or EU working groups.

During the preparation of my research, I tried not only to summarize the available information, but also to give a correct evaluation of the actual situation using also my personal experience on this subject, and to give possible solutions for the problems arised.

The need for international co-operation between financial supervisors has been acknowledged already 50 years ago, however, by that time, the regulations and the institutional framework did not support to achieve essential developments. Many important events has happened since then (for example the failure of Herstatt, BCCI, Lehmann Brothers, Northern Rock), which reflected the need of more detailed co-operation.

Globalization became relevant not only regarding the activity of credit institutions, but the whole financial supervision became global. The direct consequence of the international extension of large financial groups was the globalization of supervisory activity and created closer links between supervisors.

The integrated internal market and the relevant legislative framework of the EU gives even more possibility to improve the effectiveness of supervisory co-operation. The procedure, which has been started with the establishment of the Groupe de Contact, and lead to a single supervisory mechanism in the banking union, also shows the ability of the EU regulation to improve. While in the past the legislators needed decades to take the necessary decisions, there was only two years between the announcement of the banking union and the starting of its operation. The developments in the institutional framework of financial supervision had to keep in steps with financial innovations on the market, which was crucial to maintain financial stability in the EU.

The establishment of CEBS showed that co-operation must be carried out on a daily basis, and convergence is required not only in the field of regulation but also in supervisory methods. Using the practical experiences from the operation of CEBS, EBA has been created as an EU supervisory authority, which is actively involved in the preparation of an EU level legislative framework. While the establishment of EBA clearly had a positive impact on improving the safety of the EU banking system, but there are still some possible ways to improve the effectiveness of its decision making procedures and internal operations.

Even in the current framework there are still obstacles for effective supervisory co-operation, which are worth to examine as many of them still remains in the banking union. ECB must come over these obstacles to be able to ensure that single supervisory mechanism is really more effective compared to national solutions.

This paper examines those pros and cons which must be taken into account while deciding if a non-eurozone country should join the banking union. The discrimination in the decision making system, the lack of access to common resolution and crisis management funds, and liquidity facilities creates a situation, in which the positive factors of joining to banking union currently may not compensate for the transfer of national supervisory and resolution powers. For non-eurozone countries, it can be reasonable to wait with the joining to banking union, while in the meantime the detailed rules of the operation of the banking union may be changed in a way that this should be more convenient for a non-eurozone country to join.

The establishment of the banking union may in itself has a negative consequence on the structure of international financial groups. The single supervisory mechanism may give more incentive to transform subsidiaries into branches. If this happens, MNB will have much less supervisory power to influence the domestic operation of international groups.

This paper gives concrete proposals on how the EU financial supervisory structure could be improved, in order to keep the EU level interests as the main driver of decision making and to create more clarity in the responsibility of decision makers.

The EU should focus not only on the co-operation between national supervisors of Member States but also on the co-operation with third country supervisors. Prudential regime of third country branches is not harmonized yet, there are many divergences between the practice of Member States. The lack of a harmonized approach may lead to a presence of a market participant, which activity is not effectively regulated. This would have a negative effect on the level playing field.

The acceleration of the development in recent years does not mean that the structural and regulatory reforms has reached to the end. Based on practical experiences there is still room for improving the effectiveness of the EU financial supervisory co-operation framework. Negative consequences may arise if the development of the supervisory framework will be behind the innovations on the financial markets. EU politicians and supervisory experts have a clear responsibility in determining the proper way of further developments.

3. RESULTS

3.1 Last 40 years of international co-operation between financial supervisors

The dissertation summarizes the development of the co-operation of financial supervisors both on global and EU level. The importance of this kind of co-operation was first recognized 40 years ago, and the developments have been accelerated in the last decade. In order to better understand the main features of the problems in the field of international co-operation, it has been worth to summarize how this co-operation began and how it developed in the last 40 years. Looking at the developments, it is easy to recognize that the system of international co-operation between financial supervisors, has always been adjusted to better reflect the actual developments on financial markets. These main developments included the globalization, the importance of consolidated supervision, the need for cross-sectoral solutions and principle based supervision, and most of all, the integrated internal market of the EU.

The best way to overview the developments on the field of international supervisory co-operation is to follow the guidelines of the Basel Committee for Banking Supervision (global level), or the directives, regulations and guidelines in the EU (EU level). The legal basis of international co-operation, especially in the EU, has been developed both on quantitative and qualitative basis. The quantitative developments can be recognized as the legal basis became more and more detailed. At the same time, while at the beginning the rules of co-operation have been defined in directives, which had to be implemented in national legislations, currently most of the requirements are defined by EU regulations, which are directly enforceable in Member States (quantitative basis).

3.2 The main problems of international supervisory co-operations, and possible solutions in EU

There is no doubt that there is more and more need for better co-ordination between the national financial supervisory authorities of the Member States. The global financial crisis has showed that if the Member States plan to introduce only national measures in order to handle the crisis, that can enforce other Member States to take similar measures, and these measures altogether are rather weakening the overall EU resilience capacity to economic shocks. However, there are many obstacles for effective co-operation (such as differences in legislative basis, cultural differences, diverse supervisory methods, obstacles in information flow, secrecy rules, technical issues, differing supervisory structures, interpretation problems with directives, regulations or guidelines, geograpfical problems). The need for a single supervisory handbook and supervisory convergence has been recognized many years ago, however, looking at the current EU legislative framework there are still many ways to require higher capital from institutions at national level.

The dissertation details all those problems, where the EU soon has to find the solutions, as the global crisis has already shown, that in case of a banking crisis, or systemic risks, which may endanger financial stability, any delay or not adequate measure may have an adverse effect, which is relevant compared to the GDP of the given country.

There are at least to issues, which should have been solved on a fast way. Firstly, there is a need to ensure that EU level supervisory authorities must act based on the interest of the EU rather than national level. Secondly, there is a need for a much more effective co-operation between supervisors of different financial sectors, both on level of regulation and supervisory methodology. If the decisions of EU level supervisory authorities are mainly based on national interests, larger Member States have better possibilities to promote their own national interests. This may have a negative incentive for smaller Member States to co-operate, since they have much less voting rights. The main objective of an EU level supervisory authority shall not be to serve the German, Spanish, French or UK interests but only to promote EU interests.

There are still many sectoral divergences in case of banking, capital market or insurance regulation, and the current legislative framework does not ensure that same risks are handled in a same way in financial sectors. The European Central Bank, as a single supervisor, is responsible only for credit institutions, and financial groups lead by credit institutions. This may impose a risk that there is less attention on European level for regulation and supervision of insurance and investment firms. On a longer basis, the merger of national supervisors, or the creation of a single EU insurance and capital market supervision, similarly as banking union, may be an effective answer to these questions, within or outside European Central Bank.

The EU should give much more attention to the shadow banking entities, because in case of these entities, not always clear, which EU supervisory authority has the responsibility to supervise. Although EU decision makers are willing to develop an effective legislative framework and supervisory system for shadow banking entities, but they are still far from achieving a harmonized and integrated system on this subject.

3.3 Banking union, as a possible answer to supervisory challenges

Banking union has been invented mainly by politicians, who wanted to ensure citizens, that they are able to give a strong response to prevent future financial crisis. Banking union has started its operation only a short time ago, and at current stage it is hard to estimate if it can fulfill the role, what the politicians aimed for it. The dissertation therefore summarizes, what obstacles banking union has to face with, what kind of problems endanger the effective operation and the ability to give quick responses of the banking union, and also how to ensure that depositors of different Member States will be handled equally.

Even at this early stage, it is clear, that banking union, and especially the creation of a single supervisory mechanism, may effectively decrease the economic dependence between Member States and banks, licensed in their territories. The last financial crisis has showed that this dependence intensified the effects of the crisis and made the Member States more vulnerable. National supervisory authorities became dependent from their own large sized banks, which incented them to try to hide the real problems, which hampered to take the truely effective supervisory measures. The creation of a single supervisor will definitely lead to supervisory convergence and harmonization of supervisory expectations, which gives less possibility for banking groups to use supervisory and regulatory arbitrage.

However, resolution and deposit insurance element of banking union is quite unfinished yet, therefore they will not be able to exempt Member States from the financial burden of a possible future crisis for a while.

3.4 Pros and cons for Hungary to decide on to join Banking union

Banking union has been created mainly for eurozone countries, however, there is a possibility for non-eurozone countries to join. Before making a decision on joining the banking union, a country must evaluate the pros and cons carefully. The first concerns, that remaining outside the banking union would have a competitive disadvantage effect for Hungary, were not fulfilled, and there are no such trends on the international financial markets, which would confirm such possible disadvantages. Because of the relatively short time of being a single supervisor, the European Central Bank could not justify yet its ability to ensure a more effective way of supervision than previous systems. On a longer term, it is worth to wait while practical examples will show that ECB is more effective in financial supervision then the national supervisory authorities of Member States, and keeps itself only to the EU level interests.

A Member State should transfer its resolution and supervisory rights to a single supervisor only if it is evident, that with this transfer the financial system would become more stable and the safety net of depositors becomes stronger.

Unfortunately, the decision making system of the banking union does not really inspires non-eurozone countries to join banking union, as they would have only a limited ability to influence the decisions. In case of their disagreement, the only possible solution is to quit banking union, and their ability to rejoin will be also restricted.

Although Hungary has not joined banking union, but is the member of European System of Financial Supervision, which also gives the opportunity to ensure that its regulation and supervisory methodology could be based on common European norms and the best supervisory practice, therefore opting-out does not mean real disadvantages on this area.

As a summery after evaluating all pros and cons, a conclusion can be drawn that immediate join to banking union is not a necessary step. Although principally a country, which steps in at first stage may have a better ability to influence the internal operational rules of the banking union, but according to the decision making system of the banking union, this is not certainly true. Until the Hungarian introduction of euro, there is always a possibility to ask for joining, if there are essential changes in market, economic or legal conditions.

The pros and cons about joining the banking union can be summarized in the following sheet:

Pros and cons about joining the banking union		
	Pros	**Cons**
Competition	There is a strong supervisory and resolution power behind the banks in the banking union, which creates a competitive advantage	There are no practical signals of competitive advantage, there is no pressure from Hungarian banks that Hungary should join banking union
Transfer of supervisory powers	The largest Hungarian institutions would be supervised by ECB, as a supervisory authority with high reputation	Even the largest Hungarian banks may have less attention from ECB as they are not so relevant players at European level. The ability of Hungary to react quickly in a financial crisis would decrease, and the advantages of such transfer are not clear yet
Transfer of resolution powers	Decisions on resolutions are taken on EU level	MNB has growing experience with resolution
Taking part in decision making	Decisions are taken based on high level competencies	The ability to influence decisions is much smaller for a non-eurozone country
National interests	Priority to EU level interests	More room for handling problems at national level, which can be useful in a crisis situation
Reputation	ECB has a high level reputation, which supports the achievement of supervisory aims	ECB has a high reputation only as a central bank, it needs time to reach higher reputation as a bank supervisor
Single supervisory handbook	Domestic methodology can be based on a single and high quality EU supervisory practice	EU single supervisory handbook can be achieved and used even without being member of banking union, but opting-out gives more flexibility for domestic solutions
Macroprudential issues	Domestic macroprudential measures can be better executed in other Member State	There is less experience on macroprudential measures even at EU level
Opting-in intentions of other non-eurozone countries	If all other non-eurozone country join, it means a pressure to Hungary	At least 2 non-eurozone countries will not join banking union

4. CONCLUSIONS AND RECOMMENDATIONS

The financial supervisory system of the European Union has gone through a spectacular development process in the last 50 years. In the last decade this development has even accelerated. The development process will surely not stop after the creation of the banking union, but new measures will arise. In the history of the European Union, in case of every meaningful financial crisis, the answer of EU was the strengthening of internal co-operation.

Both regulatory and supervisory convergence gives enough room for further possibilities to co-operate. The recommendations, which can be drawn based on the historical developments, current financial environment and risks are the followings:

1. The system of banking union should be developed, in order to give more incentives for non-eurozone countries to opt-in

Such incentives could be created in many areas. The strongest incentive for non-eurozone countries to join, could be, if the institutional framework and supervisory experience of the banking union would prove, that this system is really a more effective way of financial supervision. If this is the case, the confidence of the financial markets towards credit institutions inside the banking union, would be significantly higher. This situation would inspire the banks outside the banking union to press their national governments to join. However, proving effective supervision needs time, and the real evidence of such effectiveness could be, only if banking union could give a better answer for a similar financial crisis as happened in 2008. Therefore the ECB should focus on:

- developing new supervisory methods to licensing and supervising banks, which ensure that these procedures can be carried out more effectively, based on EU level interests and methods,

- being able to discover weaknesses and vulnerabilities of the individual institutions and the financial system as a whole, and to take all necessary immediate measures in a timely manner to prevent financial crisis,
- supporting the strengthening of confidence in the financial system of Europe, which helps the competitiveness and funding capacities of EU banks,
- enforcing banks through the structure of banking union to handle the savings of the economy in a safe manner, and to provide credits to individuals and companies.

However, there are many other possibilities to inspire non-eurozone countries to join banking union. There are two main obstacles in the current regime: firstly, the voting rights of non-eurozone countries are different, and secondly, they may not reach financial contributions from financial crisis management funds and ECB liquidity facilities. Both obstacles may be handled relatively easily by changing the rules of the regime, and to give the same rights for non-eurozone countries. This could be the way, how the system would best serve the interests of the whole European Union.

2. Significant reforms should be carried out in the management, co-operation and decision making system of EU supervisory authorities

Many inconsistencies can be observed regarding the management system of EU supervisory authorities, which cause many practical problems. EU supervisory authorities has a Chair, but the main decision making body is the Board of Supervisors, which is organized and managed by the Chair. However, the Chair has no voting rights, but the Chair has to execute the decisions of the Board of Supervisors and to defend it at the public or against the stakeholders. Members of Board of Supervisors have a clear conflict of interest in many case.

According to the EU supervisory authorities' regulation, they have to make their decisions in line with EU interests, but national interests many times conflicts EU interests. In order to ensure the political independence of EU supervisory authorities, a large part of their budget is financed by the national authorities, which puts more and more financial burden for national supervisory authorities, while EU Commission, which gives only 40% of financing, still has many ways to influence the work of the EU supervisory authorities.

According to these facts, the following modifications seem to be necessary:

- The financing of EU supervisory authorities should be financed fully from EU central budget, and the yearly budget must be in line with the growing scope of activity of the EU supervisory authorities, which means a gradual increase of budget. The pre-defined gradual increase would be important to avoid the possibility of political influence. EU supervisory authorities should have the right to makee reserves, which would help their resistance to political pressures.
- The Chair and the staff should have a more important role in the decision making system and the management of EU supervisory authorities, which would reduce the conflict of interest problems.
- Joint Committe should also have a more important role, and all issues, which are relevant in financial sectors should have been discussed at Joint Committee level.

3. Institutional structure of financial supervision should be reviewed, and coherence in the field of sectoral supervisions and regulation should be strengthened

There is a clear inconsistency in the structure of EU supervision. Most of EU Member States have an integrated supervisory authority (banking, insurance and capital market supervision is carried out by the same authority, as MNB in Hungary), However, EU supervisory authorities are separated. In Hungary and in many other Member States, integrated supervisory authorities already proved, that even insurance and capital market supervision can be more effective in an integrated supervisory body. In Hungary, this integration happened in 1997 and 2000, gradually. There are many areas, where more harmonization had been achieved in the regulation of different financial sectors. It was also recognized that the main obstacle of further harmonization is the EU legislation itself, because EU was not able to create cross-sectoral harmonization.[3]

Single supervisory mechanism has been created only for credit institutions mainly based on the following assumptions:

a) In Europe, mainly banks were hit by global financial crisis, and Member States had to give financial support. As banking union is mainly a political intention, it is understandable, that the political answer had to concentrate on banks. From supervisory point of view, it is not so easy to separate banks from the other participants of the financial market, as in many countries – including Hungary as well – banks are the largest players on capital market, and many

[3] A good example for this is the regulation of agents, where Hungary has an intention long time ago to harmonize between financial sectors, but in EU, the agents of banks, investment firms and insurance companies are regulated by three different EU directives. As Hungary has to implement all these directives, the domestic regulation may not be cross-sectoral.

insurance companies are owned by credit institutions and belongs to large financial groups headed by a credit institution.

b) The central banking activity of European Central Bank is mainly restricted to banks, so ECB had experience only in case of banks. Although there were some minor cases, when ECB had to estimate the risks of insurance companies from financial stability point of view, but ECB itself has no practice in the field of insurance supervision. It became evident, that ECB wanted to take over only the supervision of banks and not insurance companies.

c) Other elements of banking union (resolution procedures and fund, deposit insurance) have been also invented mainly for banks. However, the Banking Resolution and Recovery Directive is valid not only for banks but for investment firms, and there is an investment protection scheme for the clients of investment firms (which is very similar to deposit protection).

d) Insurance companies also have close business connections with aech other (for example through reinsurance contracts), just like banks (interbank market), however, this kind of activity of insurance companies is much better regulated and supervised as in case of banks. This means that in case of insurance companies, contagion effect is much smaller and the risk that an illiquidity of an insurance company may cause the insolvency of another insurance company is rather limited. In case of banks, contagion effect was an additional negative effect of the financial crisis and regulation and supervisors did not pay enough attention to this risk before 2008.

On a longer term, consolidated supervision can be better executed in an integrated supervisory authority, because it is more effective and may better take into account the inter-connectedness of financial sectors. Information flow is more effective in an integrated body, and supervisory measures may be faster and more adequate. The transformation of the single supervisor into an integrated supervisory authority may have an additional positive elements, that rules and supervisory methodology would be better harmonized across financial sectors. This kind of transformation could also serve the idea, that the supervisory approach to different entities would be better harmonized, including those entities, which currently belong to the shadow banking area. An integrated supervisory authority can better serve the purpose of effective information flow between banking, capital market and insurance supervisors, and may have a closer and wider connection to the macroprudential authority. Even macroprudential function can be better executed if the macroprudential authority has to co-operate with less microprudential authorities.

There is also a clear need for more harmonization in the field of supervisory measures, because currently national supervisory authorities have different scope of measures, which hampers the consistent supervisory actions against each individual members of a financial group.

4. More harmonization should be achieved regarding the regulation of third country entities and connections with their supervisory authorities

CRDIV has only a limited focus on the activity of third country entities, their supervision and connections between supervisory authorities. A committee or working group should be set up to overview all related questions and issues, and provides suggestions for the possibilities to achieve more harmonization in regulation and supervisory methodology. Currently, the only relevant requirement is, that Member States may not give more favorable terms for third country branches as to branches from another Member State. Practically this wording gives room for different interpretations. In the absence of a clear and adequate regulation, third country branches may have a competitive advantage, which would give an incentive to third country financial groups to set up branches in the EU rather than subsidiaries.

As a common regulatory minimum, these branches should be obliged to send regular reports to supervisors based on CRR requirements, to disclose the same information as subsidiaries, national supervisors should be given the right to require higher capital, and a minimum dotation capital requirement should be set up for branches.

Without common regulation and supervisory methods, significant market share can be achieved by a market player, which is out of the scope of a very detailed regulatory framework and sophisticated supervision.

5. The immediate join to the banking union is not justified yet in case of Hungary

After the thorough examination of pros and cons, a conclusion can be drawn that the most suitable way for Hungary in this situation is to wait for better conditions and for the proof that banking union is more effective than previous systems. After joining the eurozone, Hungary will definitely become a member of banking union as well, but for that time being, there has always been a possibility to join, if there is a significant change in the current conditions.

5. NEW AND NOVEL SCIENTIFIC RESULTS

1. The system of the international co-operation of financial supervisory authorities has to keep in steps with the actual trends and innovations on the financial market. The analyses of historical events has showed, that the main trends in the financial sectors (such as globalization, operation in groups, financial crisis, and the way how risks became more and more complex) have an immediate effect on the system and procedures of international supervisory co-operation. Due to the integrated financial market, the co-operation of financial supervisors is even more crucial within the European Union, this is why supervisory structures and procedures of co-operation is much more detailed within the EU compared to other parts of the world.

2. There are many obstacles of international supervisory co-operations, which partly mean regulatory and structural differences, but also technical issues. It is not enough if the European Union sets up a single regulatory framework for the financial sector, if related national laws still contains many differences and divergences. The supervision of large financial groups requires the co-operation of many supervisory authorities and the number of involved participants is even higher in a crisis management. The protection of national interests, differences in languages, supervisory methods and geographical problems are also factors, which endangers the effectiveness of a successful co-operation, even within the banking union.

3. Although EU has already achieved a high quality in the co-operation of supervisory authorities, but this system still has many elements to be improved. The system of banking union should be improved in order to give more incentives for non-eurozone countries to join. The voting system should be formed in a way, which excludes the possibility for larger states to influence the decisions to better suited to their national interests. During this reform,

more emphasize should be given to further convergence regarding the supervision and regulation of different financial sectors.

4. Setting up banking union has been an essential step toward a common supervisory framework, however, it did not give perfect solutions to all possible problems. There are clear shortcomings in the voting system and crisis management procedures. Hungary, as a non-eurozone country, has to examine all pros and cons before joining banking union, and the most important question in this decision, whether the benefits of opting-in are clearly higher then disadvantages. In this relatively earlier stage of banking union, waiting for better conditions could be the most reasonable decision, immediate join is not adequate.

5. Banking union does not only creates a new regime for supervisory authorities, but also may have an effect on the future structure of financial groups. There has been already many incentives in the regulatory framework of the EU to transform subsidiaries into branches, but banking union gives even more advantages for a financial group to operate through branches. Home country supervisory tools becomes stronger, while host country supervisors are weakened. Not only solvency requirements, but also liquidity regulation gives more incentives to transform subsidiaries into branches.

6. Although EU tries to achieve a single regulation for all market participants, but so far there is less focus on third country entities. Branches of third country credit institutions should be regulated on a common basis, and the co-operation with third country supervisors should also be reviewed.

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