Acta Oeconomica Kaposváriensis (2008) Vol 2 No 2, 19-30
Kaposvári Egyetem, Gazdaságtudományi Kar, Kaposvár
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# Independence and Accountability of Financial Supervisory Authorities
# Supervision of Cross-Border Banking Activities

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***ABSTRACT***

*After dealing with the necessity of financial supervisory authorities and integrated supervisors the independence and accountability of supervisory institutions arise. Academic economists emphasize that supervisory authorities have to be independent from the governments, the politicians and the influence of the supervised financial institutions. In the real life governments have to influence financial supervisors protecting the financial system, especially in case of financial crisis. The financial supervisors have to account to the governments and the public in their reports and communication in the media. The mergers and acquisitions of banks, the expansion of cross-border banking, and the formation of financial conglomerates demand the cooperation of financial supervisory authorities in different countries. There would be conflicts of interests between the financial supervisors of the home and host countries. It would be caused by the different importance of the given financial institution in the home or host countries or the different practice of managing illiquidity and insolvency. There would be difficulties in the on-site supervisions, language problems and disagreements in politics. In the European Union the home country principle is valid in cross-border banking but the supervision is different if the foreign banking organization is a branch or a subsidiary. If it is a subsidiary the supervisor of the host country, if it is a branch the supervisor of the home country is in charge. In the European Union problems arise in the cooperation of the supervisory authorities of the home and host countries, regulating multinational financial conglomerates. Later it caused establishing lead supervisors and colleges of supervisory authorities. The unified European financial market, the cross-border activities of financial institutions arise the necessity of establishment of a pan-European financial supervisory authority. Such an organization is considered by many economists and politicians diminishing the sovereignties of countries and they do not think that it can be implemented in the near future.*
(Keywords: Financial supervision, Financial regulation, Cross-border banking)

**A pénzügyi felügyeletek függetlensége és beszámoltathatósága**
**A határokon átnyúló pénzügyi tevékenység felügyelete**

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***ÖSSZEFOGLALÁS***

*A pénzügyi felügyeletek szükségességéről és az integrált felügyeletek kialakításának kérdéseiről folyó vita után felmerülnek a pénzügyi felügyeletek önállóságának és beszámoltathatóságának kérdései is. Elméleti közgazdászok hangsúlyozzák, hogy a pénzügyi felügyeleteknek függetle-*

*neknek kell lenniük a kormányzattól, a politikusoktól és a felügyelt szektor befolyásától is. A gyakorlat azonban azt mutatja, hogy az államoknak a pénzügyi rendszer védelmében, főleg válságok idején be kell avatkozni a pénzügyi folyamatokba, befolyásolniuk kell a felügyeleti tevékenységet is. A felügyelő hatóságoknak be kell számolniuk tevékenységükről a kormányzati szerveknek és jelentéseikben, illetve a médián keresztül a nyilvánosságnak is. A bankok egyesülései, a határokon átnyúló bankműveletek elterjedése, a pénzügyi konglomerátumok megkövetelik a különböző országok pénzügyi felügyeleteinek együttműködését. Érdekellentétek jelentkezhetnek az anya- és fogadó országok bankfelügyeletei között. Ezt okozhatja az, hogy más lehet a jelentősége az adott pénzintézetnek az anya- és a fogadó országban, illetve az illikviditás és az inszolvencia kezelésében. Nehézségek jelentkezhetnek a helyszíni ellenőrzéseknél, nyelvi problémák politikai nézeteltérések is felmerülhetnek. Az Európai Unióban a határokon átnyúló banktevékenységnél az anyaországi felügyelet elve érvényesül, de különbséget tesznek aszerint, hogy a fogadó országban működő bankszerv fiókként vagy leányvállalatként működik. Előbbinél az anyaország, utóbbinál a fogadó ország pénzügyi felügyelete az illetékes. Az Unióban is jelentkeznek az anya- és fogadó országok felügyeletei közötti munkamegosztás problémái, felmerül a pénzügyi konglomerátumok egységes felügyeletének kérdése. Ez a vezető felügyeletek kialakítását, illetve a felügyeleti kollégiumok létrehozását eredményezte. Az európai pénzügyi piac kialakulása, az egyes pénzintézetek több országban folytatott tevékenysége felvetette a pán-európai pénzügyi felügyelet létesítésének szükségességét. Egy ilyen szervezet kialakítását sokan az egyes országok szuverenitását sértőnek tartják és így a közeljövőben való megvalósítását nem tartják időszerűnek.*
(Kulcsszavak: felügyelet, szabályozás, bank, nemzetközi együttműködés)

## INTRODUCTION

The recent bank crisis and credit crunch raise the question of financial regulation and financial supervision. In a previous article (*Ligeti*, 2004) we dealt with the necessity of financial supervision. Another question is whether a country needs several supervisory authorities divided by the branches of the financial industry or whether a single supervisory authority works more efficiently. The main statements of this article can be summarized as follows.

There are some economists who state that financial regulation is not needed because market imperfections and failures do not exist, regulation is too expensive and moral hazard appears. On the other hand we can state that financial regulation and supervision are necessary because customers do not have relevant information on financial institutions, cannot judge the safety and soundness of institutions when they make contracts with them and cannot follow their activities and cannot realise when an institution becomes risky. Supervisors should control soundness of financial institutions (liquidity, solvency and riskiness) because the failure of a financial institution can deteriorate the systemic stability.

One of the important roles of the financial regulation is the presence of externalities. The first externality is that banks produce money. The financial regulation and supervision can protect the value of bank produced money. The other externalities could connect with bank runs. To prevent potential liquidity problems banks have to hold more liquid assets but the existing deposit insurance reduces the sufficient amount.

Systemic issues have traditionally been important to the supervision of banks.

Market imperfections and failures demand financial supervision to protect customers. Here are some imperfections and failures (*Llewellyn*, 1999) problems of inadequate information on the part of the customer, problems of asymmetric information, potential principal-agent problems and issues related to conflicts of interest, imprecise definition of products and contracts, etc.

The speciality of financial products demands a monitoring of the activity of financial institutions. It is easier and cheaper to delegate monitoring to a specialized institution i.e. a supervisory agency, it results economies of scales is monitoring.

There are significant differences between financial and non financial products. (*Llewellyn*, 1999) Financial products are not purchased frequently and hence the customer has little experience, there is no guarantee or warranty attached, faults cannot be rectified, there is lack of transparency, it is often easy for a financial salesperson to conceal relevant information and/or mislead the customer etc. A farther rationality for supervision could be to strengthen consumer confidence in financial products. If a supervisory agency set minimum standards for financial products it could remove bad products ("lemons") from the financial markets.

The financial services sector has undergone great development. Besides traditional banking services banks have started to offer investments: securities and insurance products. Securities firms and insurance companies now offer many different kinds of financial products which never used to be part of their traditional activities. In addition non financial (e.g. commercial) firms have started to offer financial products. Financial conglomerates have been established which undertaken two or more financial services. The boundaries between different types of financial firms and financial products have been blurred.

The functioning of financial conglomerates and the new financial products demand a new approach to financial regulation. As Goodhart stated the "emergence of financial conglomerates has challenged traditional demarcations between regulatory agencies". (*Goodhart et al.*, 1998, p. 143) The risks of financial conglomerates had to be assessed on a group-wide basis and separate agencies could not evaluate the risk of a conglomerate properly. The activities of the separate agencies should be coordinated or the different agencies should be united into an integrated (single) financial supervisory agency.

Economies of scale and scope should arise because an integrated regulator can centralise several activities, can avoid unnecessary duplication or overlapping across multiple specialised agencies and because of these the cost of a single supervisor could be lower than that of the separate agencies.

A single regulator can use unified regulatory and supervisory methods, can increase transparency and accountability of the regulatory and supervisory processes. But there are some arguments against the single regulator: (it) "could potentially be an over-mighty bully, a bureaucratic leviathan, divorced from the industry it regulates." (*Taylor*, 1995, p. 15)

There are great discussions in academic literature on the central bank's combined role as a monetary and regulatory authority. *Briault* (1999) summarises the arguments against combining these functions because the central bank has a contradiction between managing monetary policy (loosening, tightening) and helping the financial health of financial firms as a supervisory, regulatory agency. If the central bank fails as a supervisor it can diminish its credibility as a monetary policy authority. The wider the role of a central bank, the greater the risk; that its function will be subject to political pressure or political control and that the government will interfere in its monetary policy. Some countries combined the central bank's monetary and supervisory functions. They argue that the lender-of-last-resort function of the central bank is not influenced by the supervisory role, keeping the health of the banking system. The central bank usually interferes when there are some problems with the payment system. At the time of liquidity problems the central bank can guarantee the smooth functioning of the payment system. *Peek et al.* (1999) have another point for the cooperation of monetary and regulatory authorities. They find that supervisory information can be used by the monetary policy makers to improve their decisions. It is important if a central bank has no supervisory responsibilities, at least it should have access to supervisory information.

There are arguments for and against whether a central bank can help if one or more important financial institutions are illiquid or insolvent. Many economists state that it is not the central bank's task but I think the central bank has to prevent contagion and a possible run on the whole banking system. The events in 2008 prove that the central banks had to prevent the collapse of the banking system and the economy.

## INDEPENDENCE AND ACCOUNTABILITY OF FINANCIAL SUPERVISORY INSTITUTIONS[1]

### Independence of Financial Supervisory Institutions

Most of the economists and politicians agree in the independence of central banks. But there are different views on the independence of financial supervisory institutions. The opponents of the independence of financial supervisory institutions argue that the independent supervisor carries out governmental functions regulating and supervising private institutions (banks and other financial institutions) limiting their activities with rule making, enforcement and sanctioning. Some economists think that there is a contradiction between the independence and accountability of supervisory institutions but the majority agrees that without accountability the supervisory institution becomes a self centred, self-complacent organization.

The independence has two interpretations – independence form politicians and from the regulated industry. Politicians incline to influence the regulatory and supervisory authorities to avoid stronger steps against weak banks fearing of the negative consequences in their constituencies. Industrial (financial) firms are trying to influence the regulatory, supervisory authorities protecting their own interest rather to the public interest. The most important argument for independence of financial regulatory and supervisory institutions is the need of financial stability. Politicians usually follow short-run purposes which contradict the long-run purposes of an economy. E.g. politicians are against liquidation of failing banks because these are unpopular for depositors among their voters who demand from politicians to protect their banks. But the recent financial crisis proved that even governments and central banks can help illiquid or insolvent financial institutions. Political and regulatory forbearance is dangerous because it means moral hazard, negligence of bank managers and customers.

The independence of institutions can be classified as follows. The institutional independence means that an agency, an institution is separated from the executive and legislative branches of the government. It includes the terms of the appointment and dismissal, security of tenure its senior personnel, the agency's governance structure, the openness and transparency of decision making. Regulatory independence means that the agency has an appropriate degree of autonomy in setting prudential rules and regulations for the financial sector, to prevent intervention of governmental organization which can endanger the stability of the financial system. Supervisory independence means the independence with which the agency is able to carry out its activity, among others

[1] With the problems of independence and accountability of financial supervisory institutions deals *Masciandoro* (2007 pp. 3-206) and *Hüpkes* (2005 pp. 19-34)

licensing, on-site inspections, off-site monitoring, sanctioning, revoking licenses. Budgetary independence means that the agency can determine its budget and allocation of its resources. If the resources of a supervisory agency are financed by the central budget or ministerial allowance its independence is diminishing. From this point of view the best solution is if the budget is financed from fees and levies paid by financial institutions.

**Accountability of Financial Supervisory Institutions**

The Oxford English Dictionary defines accountability as "obliged to give a reckoning or explanation for one's actions, responsibility." Responsibility is defined as "legally or morally obliged to take care of something or to carry out a duty; liable to be blamed for loss or a failure." This definition assumes a vertical relationship between an accountee and an accountor. In the case of financial regulatory and supervisory institutions more stakeholders are concerned. Such as the government, governmental bodies, the financial industry, customers. So the financial supervisor has both vertical and horizontal accountability. In addition there is a necessity of publications on the activity of supervisory institutions in the media, the press and on the Internet.

The accountability of institutions can be classified as follows. The institutional accountability means that the financial supervisory agency has to report to the parliament, parliamentary committees, to the government. Usually the ministry of finance is in charge of the activities of the financial supervisor. The accountability does not mean that the legislative, governmental bodies can directly interfere into the operations of the financial supervisory authority. Regulatory accountability is arisen if a supervisory authority has rule-making powers. These powers have been delegated by the legislative bodies of the given country. The supervisory institution is accountable to different stakeholders for its rule-making decisions. The supervisory accountability means that the financial institutions and individuals who are affected by the decisions of the financial supervisors can apply to a court or other judicial authority to review of consequences of these decisions. The budgetary accountability means that the financial supervisor has to present its balance sheet, financial accounts, incomes and the distribution of its expenditures. The difference between the accountability of central banks and supervisory institutions that the central banks have numerical targets (e.g. money supply, the level of inflation or the foreign exchange rate), the financial supervisory institutions have not.

## LICENSING BANK ACTIVITY AND EXIT OF BANKS

One of the most important problems of supervising financial institutions is licensing[2]. The reason is that banks have pivotal role in the economy. The main considerations are as follows (*Llewellyn*, 1999, p. 13.):

- "the pivotal position of banks in the financial system, especially in clearing and payment systems,
- the potential systemic dangers resulting from bank runs,
- the nature of bank (debt) contracts on both sides of the balance sheet,
- adverse selection and moral hazard associated with safety-net arrangements (lender-of-last-resort) and deposit insurance."

[2] *Padoa-Schioppa* deals in details with licensing (2004 pp. 14-31)

Insolvent or illiquid banks can endanger solvent banks causing a bank run. A possible run can reduce the value of banks' assets because they have to sell assets before they reach maturity. If the illiquid bank is large enough panic can spread to other banks at a considerable speed. If a bank is insolvent, depositors are paid on a first-come-first-served base which can accelerate the withdrawal process. The other point is that if a large bank is insolvent the customers do not believe in the soundness of the banking system and a chain reaction can start.

In addition to the characteristics of the banks there are other reasons of licensing. New, innovative financial products and non-bank-banks appeared on the financial markets. These new products are the derivatives, securitization, and the growing role of electronic payments. The licensing of banks and other financial institutions can reassure customers that the supervisor check whether a bank fulfils the preconditions of prudent financial activity and has a proper risk management system and its new products.

Not only licensing but the other end of banks' life (revoking licenses or exit) is important as well[3]. The supervisory authority has to monitor the activity of financial institutions, their capital adequacy, liquidity, solvency to prevent failing of the banks. If a bank becomes illiquid or insolvent other banks can help, the central bank can grant credit as a lender-of-last-resort, the deposit insurance organization can pay out depositors, the government can bail out. Finally, if the other solutions are failed the financial authority has to revoke the licence of the banks and this way it can affect the soundness of the banking system.

## THE RATIONALE OF FINANCIAL SUPERVISION, THE NEED FOR CHANGE

Different opinions on the need for financial regulation and supervision are shown in the debate of Nobel Prize winners (*Perry*, 2008).

"Many of the laureates' criticism focused on the notion that banking has drifted from its fundamental purpose. Amid a rush to profit what's been lost is the idea that a banker has some responsibility to protect the client's interest, said Daniel McFadden, who won the Nobel Memorial Prize in 2000. … But a rush to regulation could have dire consequences, warned Myron Scholes, who took the Nobel Prize in 1997. He added: sometimes the cost of regulation might be far greater than its benefits. … Joseph Stiglitz, who won the Nobel in 2001, suggested misguided innovation itself caused the current turmoil… they created risks, and now we're bearing the consequences of this so-called innovation." They agreed that the Basel II focuses on managing daily risk are not enough on handling crises. As McFadden said: "We may need a financial-instrument administration that tests the robustness of financial instruments and approves only the uses where they can do no harm."

After the credit crunch spreading from the USA banks and other financial firms they broadly agree that new laws and rules are necessary. But they worry that regulators over-step the bounds of reasonableness and could damage the efficiency and profitability of the financial sector (*Nelson*, 2008). The international organizations who want to strengthen the role of financial regulatory and supervisory institutions are the G7 finance ministers and central bank governors, the Financial Stability Forum, the International Monetary Fund, and the Basel Committee on Banking Supervision, the International Organization of Securities Commissions, the International Association of Insurance

[3] *Mayes* (2001 pp. 198-256) deals with the problems of exit in details.

Supervisors and the International Accounting Standard Board. The national supervisory authorities and lawmakers also propose improving financial supervision.

The April 2008 report of the Financial Stability Forum (*Nelson*, 2008) recommends changes in the countries' financial supervisory system to strengthen prudential oversight of capital, liquidity and risk management, enhance transparency and valuation, improve the role and use of credit ratings, strengthen the authorities responsiveness to risks, make robust arrangements for dealing with stress in the financial system. They suggest that bonuses of the management should be based on long-term not short-term profits of the financial institutions.

From the national proposals I emphasize the US Treasury Secretary Henry Paulson's long-term recommendation in which he suggests to replace the current "functional regulation" (separate bodies for banking, insurance, securities and futures) with a new one, consisting a market stability regulator, a prudential regulator and a business conduct regulator.

In May, 2008 the British Treasury announced that a Banking Reform Bill will be introduced (*Nelson*, 2008) including the improvements to the Financial Services Compensation Scheme to facilitate faster payout to depositors, to allow authorities to intervene when a bank gets into difficulties, revising the framework for the provision liquidity. The British Bankers' Association is afraid of the too hasty and aggressive legislative timetable and supervisory rules.

Jaime Caruana, Director of the IMF's Monetary and Capital Markets Department said that policymakers and financial institutions need to act together and that there is a big bonus on the latter to solve many of the problems themselves. "Stronger supervisory oversight is needed from the public sector, but regulation and supervision cannot substitute for effective risk management by private agents and can, if taken too far, exacerbate moral hazard." (*Nelson*, 2008, p. 6.)

## SUPERVISION OF CROSS-BORDER BANKING

The increasing cross-border banking and the spill-over effects from the closure of a bank in a given country to partner banks in other countries demand the supervision of international banking activities. The first important failure was in 1974 when the German authorities closed the Herstatt bank at the end of the business day, but it was morning in New York and the American banks did not receive their payment from Germany, suffered losses. After the collapse of Herstatt the predecessor of the Basel Committee on Banking Supervision was established in February 1975. The first document of the Basel Committee, the Condordat stated that no foreign banking establishment should escape supervision, supervision is the joint responsibility of the host and home supervisors, the supervisors should transfer information. After the Concordat the first crisis was the collapse of the Italian Banco Ambrosiano in 1983. The Italian creditors of the bank were bailed out by the Italian authorities and a consortium of Italian commercial banks but the creditors of its subsidiaries in Luxembourg, in Peru, in the Bahamas were not bailed out. The revisions of the Basel Concordat did not prevent the next famous failure, the collapse of the Bank of Credit and Commerce International (BCCI) in 1991. The BCCI was incorporated in Luxembourg; the owners were Arabs, operated in app. 70 countries, had a widespread retail network in the United Kingdom, the management decisions were made in Pakistan and London. This structure caused that the bank could avoid consolidated supervision in all countries of its activity.

After the collapse of the bank the "BCCI Directive" coordinating the activities of supervisors came into effect (*Herring*, 1995, 2007).

The subprime mortgage credit crises started in the USA and the securitization of these mortgages caused considerable losses for some European banks. This demands not only supervising cross-border banking activities but supervising the new, so called innovative financial products as well.

## THE COORDINATION OF FINANCIAL SUPERVISORY ACTIVITIES

Many economists compare the need for international coordination of financial supervisory institutions to public health authorities (*Herring*, 1995): The coordination of the struggle against epidemics of diseases had needed a century, which is not too promising.

The international cooperation between financial supervisory institutions is more likely (*Herring*, 1995, p. 124.):

- "the smaller the group of countries that must agree;
- the broader the international consensus on policy objectives and potential gains from cooperation;
- the deeper the international agreement on the probable consequences of policy alternatives;
- the stronger the international infrastructure for decision making; and
- the greater the domestic influence of experts who share a common understanding of a problem and its solution."

There should be differences between the operations and principles of the national financial supervisory institutions (*Wright*, 2007).

Objectives are set in national statues and vary widely; scopes can differ (e.g. banks, securities firms, hedge funds, insurance companies, etc.); powers can differ nationally e.g. insolvency and depositor-investor protection; preferring prudential or conduct of business supervision; appetites toward risk, etc. These differences can result several problems in coordinating operations of national financial supervisory authorities.

## RELATIONS AND CONFLICTS BETWEEN THE HOME AND HOST FINANCIAL AUTHORITIES

The analyses, statements, publications of the Basel Committee can promote the coordination between the supervisory institutions can diminish their conflicts in supervision of cross-border banking.

Following the collapse of the BCCI in 1991 the Basel Committee issued "minimum standards" for home and host authorities that are as follows (*Song,* 2004, p. 7.).

- "All international banking groups and international banks should be supervised by a home country authority that capably performs consolidated supervision.
- The creation a cross-border banking establishment should receive the prior consent of both the host country supervisory authority and the bank's and, if different, the banking group's home country supervisory authority.
- Supervision authorities should possess the right to gather information form cross-border banking establishments of the banks or banking groups for which they are the home country supervisory authority.

- If a host country authority determines that any of the foregoing minimum standards are not met to its satisfaction, that authority could impose restrictive measure necessary to satisfy its prudential concerns."

Many economists believe that the Basel II would improve the cooperation between home and host country authorities.

There could be conflicts between the home and host authorities because of the differences of financial and human capital, differences of the countries legal and accounting systems. It should be a conflict if a given banking entity has a different importance in the home and the host country. It is possible that a bank is not significant in the home country but very important in the host country. In that case the home country supervisory authority is not too interested in the fate of the subsidiary in the host country. The role of the home and host country supervisory authority is different. In the case of a branch the home country supervisory authority, in the case of a subsidiary the host country supervisory authority are in charge.

Promoting cooperation in cross-border supervisory operations many countries sign bilateral Memorandum of Understanding (MOU), which can include exchange of information, inspection, and remedial or punitive actions, etc.

The New Zealand supervisory authority introduced a completely different method (*Herring*, 2007; *Kane*, 2006). Since more than 85 percent of the banking system is controlled by foreign-owned banks, the New Zealand authority forced the foreign entities to be organized as subsidiaries, so the New Zealand financial supervisor is in charge.

## FINANCIAL SUPERVISION IN THE EUROPEAN UNION

The regulation and supervision of cross-border financial activities encounter difficulties because there are differences in financial products, consumer habits, the role and scope of financial supervisors, the tax systems, regulation, competition, and preferences of politicians in different countries.

The supervision of cross-border financial operations is promoted by the Capital Requirements Directive, the establishment of colleges of supervisors, introducing lead supervisors, the operation of level 3 committees.

The Lamfalussy process, which is one of the principles of the financial supervision in the European Union, has 3 levels.

Level I consist of legislative acts, namely directives or regulations proposed by the Commission adopted by the Council of Ministers and the European Parliament.

Level II Commission-chaired committees deal with relevant technical adjustments or implementing measures.

Level III committees of national supervisors act as an advisory group to assist the European Commission promoting implementation of Community legislation in Member States, improving coordination amongst national supervisory authorities, enhancing the convergence of supervisory practice. The level 3 committees are as follows: the Committee of European Banking Supervisors, the Committee of European Securities Regulators (CESR) and the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS).

In the European Union the principal is the home country control, but if the foreign entity is a subsidiary the host country supervisor is in charge. The home country supervision can be efficient because the supervisor of the home country can evaluate the operation of the financial conglomerate but not too efficient from the point of view of the host country. The supervisor of the home country meets difficulties in on-site supervision in the host country, does not understand the language of the host country, it should cooperate with the supervisory authority of the host country. Thanks to the home country principle, supervisors are able to achieve a more complete vision of the important risks to the national financial systems, but not in the case of the branches. The proximity of the host supervisor to the subsidiary institution and markets in which it operates allows a better oversight and understanding about their activities and risks. But the allocation of responsibilities between the two supervisors is unclear in some cases, it can be duplication of costs, it demands exchange of information.

Improving the coordination of the supervisors of home and host countries the lead supervisor model was introduced. The home country's supervisors lead a college of supervisors including the supervisors of all countries in which the parent bank has subsidiaries. The advantages are that the lead supervisor has a full vision of activity and risk taking of the group, reduces (eliminates), the duplication of supervision and its costs. There are disadvantages as well. The potential disconnection between the allocation of supervisory competences/responsibilities (home country supervisors) and the destination of the impact and consequences in the event of failure or crisis (host country financial system). The allocation of capital within the group is determined by the home country supervisor. The authorities in the host countries do not have global view of their financial system, if the majority of the financial institutions are supervised by home country authorities. If there are too many subsidiaries in a country, different home country supervisory rules are used in the host country. It seems that the lead supervisor model does not present a final solution.

The cross-border operations of European financial institutions and the problems of cooperation of national financial supervisory institutions arose the establishment of a pan-European financial supervisory authority. In December 2007 Italian Minister of Economy Tommaso Padoa-Schioppa suggested adopting a single European rulebook, institutionalising integrated supervision on cross-border groups based on common rules, to enhance the scope the Level 3 Committees. *Ingres* (2007) has a similar suggestion for establishment a central ruling authority, which later can be transformed into a central supervisory authority. Some economists propose that a pan-European supervisory authority is needed. It could be problematic because of the different financial and legal systems, different languages and political problem that the supranational supervisor limits the sovereignty of each country. Because of these I think the pan-European financial supervisory authority can only be established in the long run.

## SUMMARY

There are arguments for and against financial regulation and supervision. The economists who argue that there is no need for financial supervision state there are not market imperfections. The recent financial crises showed that there were market imperfections and market failures. The majority of discussants state that there is a need for financial regulation and supervision. Summarising the pros and cons for financial regulation I think that there is a need for supervisory authorities as in other important industries as well e.g. Food and Drug Administration, Energy Supervision, etc.

After dealing with the necessity of financial supervisory authorities and integrated supervisors the independence and accountability of supervisory institutions arise. Academic economists emphasize that supervisory authorities have to be independent from the governments, the politicians and the influence of the supervised financial institutions. In the real life governments have to influence financial supervisors protecting the financial system, especially in case of financial crisis. The financial supervisors have to account to the governments and the public in their reports and communication in the media. The mergers and acquisitions of banks, the expansion of cross-border banking, and the formation of financial conglomerates demand the cooperation of financial supervisory authorities in different countries. There would be conflicts of interests between the financial supervisors of the home and host countries. It would be caused by the different importance of the given financial institution in the home or host countries or the different practice of managing illiquidity and insolvency. There would be difficulties in the on-site supervisions, language problems and disagreements in politics. In the European Union the home country principle is valid in cross-border banking but the supervision is different if the foreign banking organization is a branch or a subsidiary. If it is a subsidiary the supervisor of the host country, if it is a branch the supervisor of the home country is in charge. In the European Union problems arise in the cooperation of the supervisory authorities of the home and host countries, regulating multinational financial conglomerates. Later it caused establishing lead supervisors and colleges of supervisory authorities. The unified European financial market, the cross-border activities of financial institutions arise the necessity of establishment of a pan-European financial supervisory authority. Such an organization is considered by many economists and politicians diminishing the sovereignties of countries and they do not think that it can be implemented in the near future.

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