

## E THE EU ARRANGEMENTS FOR FINANCIAL CRISIS MANAGEMENT

*Since the introduction of the euro, the progress made in the integration of financial markets and market infrastructures in the EU, the growing number of internationally active institutions and the diversification of financial activities have increased the liquidity and efficiency of the relevant markets. At the same time, however, such developments have also increased the likelihood that systemic disturbances could affect more than one Member State, and possibly increase the scope for cross-border contagion. In this context, the specific arrangements for handling crises at the EU level between the authorities responsible for safeguarding financial stability have been considerably enhanced since the introduction of the euro. The enhancements include legislative initiatives in the framework of the Financial Services Action Plan (FSAP), the implementation of the Lamfalussy framework for regulation and supervision in all financial sectors, the adoption of agreements on voluntary cooperation between responsible authorities, and the development of practical arrangements, such as the organisation of financial crisis simulation exercises. This Special Feature provides a structured overview of the progress made in the specific arrangements for financial crisis management between central banks, banking supervisors and finance ministries. Arrangements involving other authorities, such as other sectoral financial supervisors or deposit-insurance schemes, are not dealt with in this Special Feature.*

### INTRODUCTION

The EU – and the euro area in particular – displays the features of a single financial market, given the increasing degree of financial integration at the level of markets, market infrastructures, and financial institutions including the large and complex financial institutions operating across Member States. These developments are significantly improving market liquidity and efficiency, while at the same time leading to broader and deeper

systemic interlinkages between Member States. This suggests that potential financial disturbances are more likely than before to spread across borders, thus potentially affecting more than one Member State. Accordingly, the EU's arrangements for financial stability increasingly have to take into account the cross-border spillover potential of a financial disturbance.

The EU's financial stability framework is largely based on the exercise of the statutory responsibilities of central banks, financial supervisors and finance ministries. The enhancements of the specific arrangements for dealing with potential crisis situations have focused on the coordination and wider cooperation processes, both between the different sets of authorities and across Member States. The overall objective of such enhancements is to support the effectiveness of the performance of financial stability tasks in the single financial market by facilitating the exchange of information and the consistency of potential policy actions between the responsible authorities.

This Special Feature is organised into six sections as follows. First, it recalls the initial impetus to the enhancement of EU crisis management arrangements, via recommendations endorsed by the Economic Financial Committee (EFC) in 2000 and 2001.<sup>1</sup> Second, it reviews the implementation of these recommendations, notably regarding the adoption of voluntary cooperation agreements between authorities. Third, it addresses those legislative initiatives at the EU level that have a specific bearing on financial crisis management arrangements. Fourth, the Special Feature completes its overview of the EU's framework for crisis management with a reference to central banking arrangements.

<sup>1</sup> The EFC is established by the Treaty to provide advice to the ECOFIN Council and to the Commission. In an ad-hoc composition dealing with financial stability related-issues (Financial Stability Table), it comprises high-level representatives from finance ministries and central banks.

Fifth, it refers to the initiatives taken to enhance the effectiveness of the arrangements to address cross-border financial crises, which include the organisation of financial crisis simulation exercises at the EU level. Finally, this Special Feature concludes with an assessment of the progress achieved in the enhancement of the EU's arrangements for financial crisis management.

#### THE EFC RECOMMENDATIONS REGARDING FINANCIAL CRISIS MANAGEMENT ARRANGEMENTS

Following the introduction of the euro on 1 January 1999, the arrangements for financial stability at the EU level were reviewed, taking into account the increasing level of financial integration in the EU and the euro area. The aim was to assess whether these arrangements were still able to accommodate changes in the financial markets and to provide sufficient safeguards of financial stability. In April 2000 the EFC issued a "Report on Financial Stability", which concluded that the institutional arrangements provide a coherent and flexible basis for safeguarding financial stability in increasingly integrated markets, but that their operational functioning needed some enhancements. The recommendations endorsed by the EFC and subsequently by the EU Council of Ministers of Economic Affairs and Finance (the ECOFIN Council), included (i) strengthening cross-sectoral cooperation, (ii) enhancing exchanges of information between the responsible authorities, (iii) reinforcing cooperation between supervisors and central banks to tackle crisis situations, and (iv) working on the convergence of supervisory practices.<sup>2</sup>

As a key component of the broader financial stability framework, the EFC examined the specific arrangements for financial crisis management in a special report issued in April 2001.<sup>3</sup> While considering that the first line of defence should remain within financial institutions themselves, the major conclusion of the report was the need to strengthen cross-border cooperation and coordination still

further between the responsible authorities in order to ensure the effective safeguarding of financial stability.

Accordingly, the EFC and subsequently the ECOFIN Council endorsed the following four main recommendations to improve the practical functioning of the EU's financial crisis management arrangements.

First, supervisory authorities should take measures to ensure that large financial groups produce accurate information at short notice, have adequate contingency procedures in place, and perform stress-testing exercises on a regular basis.

Second, Member States should remove any remaining legal or practical obstacles which could prevent the timely exchange of necessary information, both cross-border and cross-sector, among supervisors, central banks, overseers of payment systems and bodies administering deposit-guarantee schemes. In addition, each authority should develop its own checklist, which should identify the main issues to be addressed in a crisis as well as specify which other authorities have to be informed.

Third, the development of clear ex ante agreements was recommended to deal with information-sharing issues and the assignment of responsibilities among competent authorities in the event of a crisis, especially for the major financial groups, preferably on a multilateral basis.

Finally, competition authorities were called upon to maintain timely and robust procedures for considering the competitive implications of crisis management measures.

Following the 2001 recommendations, the EFC was invited by the ECOFIN Council to continue to give high priority to crisis management in

<sup>2</sup> Available at [http://ue.eu.int/ueDocs/cms\\_Data/docs/pressdata/en/misc/ACF16BD.htm](http://ue.eu.int/ueDocs/cms_Data/docs/pressdata/en/misc/ACF16BD.htm)

<sup>3</sup> Available at [http://www.consilium.europa.eu/ueDocs/cms\\_Data/docs/pressdata/en/misc/Brouwerreport.html](http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressdata/en/misc/Brouwerreport.html)

following up its reports. As a result, new priorities for enhancing the EU framework for financial stability and crisis management were set by the EFC in 2004. In particular, special attention was paid to the extension of the arrangements on crisis management to finance ministries and to the organisation of an EU-wide financial crisis simulation exercise involving the relevant authorities. These specific developments are described below.

#### THE FRAMEWORK FOR VOLUNTARY COOPERATION BETWEEN THE AUTHORITIES

Enhancements for cooperation among EU authorities in the area of crisis management are to a large extent based on voluntary agreements between various authorities, which set out procedures for cooperation and information-sharing in potential crisis situations. These agreements have been adopted at the EU, regional and domestic levels.

#### MEMORANDA OF UNDERSTANDING ON COOPERATION IN CRISIS MANAGEMENT AT THE EU LEVEL

The Memoranda of Understanding (MoUs) on crisis management are now important components of the EU's institutional framework for safeguarding financial stability. They are generally designed to provide basic principles and practical arrangements for cross-border cooperation between authorities in the case of cross-border and systemic financial disturbances. Systemic implications can materialise through disturbances in individual banks, banking groups or banking components of financial groups, as well as in disturbances in the financial markets, payment systems or other market infrastructures.

There are currently two multilateral MoUs on crisis management in force which have been adopted by the responsible authorities of all EU Member States. The MoUs are not legally binding and are based on the principle of voluntary cooperation, as they are without prejudice to the exercise of statutory responsibilities by the relevant authorities.

Following up on the 2001 EFC recommendations, the first EU-wide MoU on cooperation in crisis management situations was adopted under the auspices of the ESCB's Banking Supervision Committee (BSC) in March 2003, entitled the "Memorandum of Understanding on High-Level Principles on Co-operation between the Banking Supervisors and Central Banks of the EU in Crisis Management Situations".<sup>4</sup> This MoU was designed to contribute to effective crisis management by ensuring smooth interaction between the authorities concerned, thus facilitating an early assessment of the systemic scope of a crisis both at the domestic and EU levels. For this purpose the aforementioned MoU sets out specific principles and procedures for the identification of the authorities responsible for crisis management in the EU, the required flows of information between banking supervisors and central banks, and the practical conditions for sharing information at the cross-border level. It also establishes an infrastructure for cross-border communication between banking supervisors and central banks, including a list of emergency contacts.<sup>5</sup>

Following up on the priorities set by the EFC in 2004 mentioned above, the second MoU on cooperation in financial crisis situations, entitled a "Memorandum of Understanding on Co-operation between the Banking Supervisors, Central Banks and Finance Ministries of the EU in Financial Crisis Situations", was adopted by the 76 EU banking supervisors, central banks and finance ministries under the aegis of the EFC in May 2005.

This MoU consists of a set of principles and procedures for sharing information, views and assessments, in order to assist these authorities

4 The ESCB Banking Supervision Committee contributes to the macro-prudential and structural monitoring of the EU financial system, to the cooperation and exchange of information between banking supervisors and central banks on issues of common interest, and to the analysis of the impact of regulatory and supervisory requirements on financial stability.

5 See the related press release available at [http://www.ecb.int/press/pr/date/2003/html/pr030310\\_3.en.html](http://www.ecb.int/press/pr/date/2003/html/pr030310_3.en.html). The authorities of the new Member States adhered to this agreement in June 2004.

in pursuing their respective policy functions and to preserve the overall stability of the financial system of individual Member States and of the EU as a whole. In particular, the authorities concerned should be in a position, if needed, to engage in informed discussions amongst themselves at the cross-border level through existing networks and committees, for example following the emergence of a crisis situation that affects the financial system of more than one Member State or the EU as a whole.

To support further the enhanced cooperation between authorities, the 2005 MoU also includes arrangements for the development of contingency plans for the management of crisis situations, along with stress-testing and simulation exercises.<sup>6</sup>

Lastly, the MoU includes an explicit statement that it should not be construed as representing an exception to (i) the principle of the firm's owners'/shareholders' primary financial responsibility, (ii) the need for creditor vigilance, and (iii) the primacy of market-led solutions when it comes to solving crisis situations in individual institutions.

In addition to the MoUs on crisis management, an MoU is also in place regarding cooperation between banking supervisors and central banks in their capacity as overseers of the payment system, which entered into force in January 2001.<sup>7</sup> Although this agreement does not specifically focus on crisis management, it does contain a number of relevant provisions dealing with the transmission of information in case of liquidity or solvency problems. This relates to the risk that the inability of a market participant to meet its obligations in a large-value payment system could jeopardise its counterparties' ability to meet their obligations at short notice, which therefore represents a relevant source of contagion.

#### **BILATERAL OR REGIONAL AGREEMENTS**

The EU-wide MoUs on crisis management provide a broad framework for voluntary

cooperation between the authorities responsible for safeguarding financial stability at the EU level and at the domestic level. This broad framework was and still is in the process of being specified at the bilateral and regional levels.

In line with the recommendations of the 2001 EFC report on crisis management, the authorities from individual Member States may require closer cooperation structures, for instance as a result of specific systemic interlinkages stemming from banking groups with significant presence in their respective Member States. These enhanced cooperation structures have been set up in the form of bilateral or regional agreements, although it is likely that many of the older bilateral MoUs may need to be updated to fully reflect recent thinking on crisis management.

One of these regional agreements consists of the MoU on the "Management of a Financial Crisis in Banks with Cross-border Establishments", which was adopted by the central banks of the Nordic region – Denmark, Finland, Iceland, Norway and Sweden.<sup>8</sup> This agreement is based on two principles. First, the cooperation between the central banks will be facilitated by the establishment of a structure for crisis management and the dissemination of relevant information. Second, the non-legally binding nature is considered an appropriate way for facilitating cooperation between central banks without curtailing their flexibility as independent institutions. On the basis of these principles, the central banks of the Nordic region have drawn up an agreement addressing the significant cross-border activity of one particular Nordic banking group which may have repercussions for financial stability in more than one of these countries.

6 See the related press release available at [http://www.ecb.int/press/pr/date/2005/html/pr050518\\_1.en.html](http://www.ecb.int/press/pr/date/2005/html/pr050518_1.en.html)

7 See the related press release available at <http://www.ecb.int/press/pr/date/2001/html/pr010402.en.html>

8 Available at <http://www.riksbank.com/>

The MoU between the Nordic central banks specifies the provisions of the 2003 MoU between EU banking supervisors and central banks as mentioned above. While the EU-wide MoU provides a broad framework, the Nordic MoU sets more specific and detailed arrangements for cooperation and information exchange concerning the management of crises affecting banking groups. It includes conditions for measures regarding liquidity and solvency, practical arrangements with regard to the operational mechanism for the coordination of central banks (in the form of a crisis management group), specifications on the necessary contacts and information-gathering, and the coordination of public communication.

The Nationale Bank van België/Banque Nationale de Belgique, the Commission Bancaire, Financière et des Assurances and De Nederlandsche Bank have also recently adopted a regional agreement.<sup>9</sup> As in the case of the Nordic countries, the adoption of this agreement is based on the assumption that the financial systems of Belgium and the Netherlands are so closely intertwined that they require further reinforcing cooperation in the area of supervision and in the case of a possible financial crisis.

To this purpose, this agreement aims at facilitating cross-border cooperation also by setting up a crisis management committee composed of the three authorities, which would deal with consultation and coordination practices, collect information, prepare decisions and maintain contacts with the institution and market participants. In addition, the MoU aims at making specific information available in a crisis. Lastly it also acknowledges the need for closer cross-border cooperation, as required by the new EU Capital Requirements Directive.

#### DOMESTIC AGREEMENTS

The domestic arrangements for financial crisis management also form an important component of the EU's overall financial stability framework. Effective communication and policy actions at the cross-border level depend to a large degree

on the smoothness of the interactions between authorities in the domestic setting.

In certain Member States domestic agreements have been reached between the authorities responsible for safeguarding financial stability with the aim of facilitating the interaction between the different policy functions at the national level in potential crisis situations. A relevant example is the MoU in the UK, which establishes a framework for cooperation in the field of financial stability between the Treasury, the Bank of England and the Financial Services Authority. It sets out the role of each authority, and explains how they work together towards the common objective of financial stability in the UK.<sup>10</sup>

#### EU COMMITTEES

A number of committees organise cooperation and information-sharing at the EU level between the authorities responsible for safeguarding financial stability. The relevant committees include the EFC, the BSC and the Committee of European Banking Supervisors (CEBS),<sup>11</sup> whose membership comprises banking supervisors and central banks; and the Financial Services Committee (FSC), whose membership comprises representatives of finance ministries.

These committees play an important role in enhancing the arrangements for financial crisis management, as was the case with the existing MoUs. In cases where EU-wide multilateral cooperation among the authorities might be needed, the existing EU committees may, within the scope of their role and tasks, be used to

9 See the related press release available at <http://www.nbb.be/>, <http://www.dnb.nl/>, and <http://www.cbfa.be/>.

10 The MoU is available from the Bank of England's website: <http://www.bankofengland.co.uk/financialstability/mou.pdf>

11 According to the Commission decision 2004/5/EC of 5 November 2003, the role of the CEBS is to: advise the Commission, in particular as regards the preparation of draft implementing measures in the field of banking activities; contribute to the consistent implementation of Community Directives and to the convergence of Member States' supervisory practices throughout the Community; and enhance supervisory co-operation, including the exchange of information.

facilitate the process of exchange of information, views and assessments.

### THE EU'S LEGISLATIVE FRAMEWORK ON CRISIS MANAGEMENT

The FSAP, which was completed in 2005, led to a number of legislative acts which reinforced the regulatory and supervisory frameworks at the EU level. Some of these acts introduced provisions which have a direct bearing on crisis management situations, notably in terms of defining information flows between the authorities potentially involved in the management of cross-border crises, including supervisors and central banks.

### THE CAPITAL REQUIREMENTS DIRECTIVE

The Capital Requirements Directive (CRD), which transposes the Basel II Framework into EU legislation, sets forth requirements in Articles 129 to 132 concerning the division of labour and the coordination and cooperation between home and host supervisors relating to the monitoring and supervision of banking groups, both in normal times and in emergency situations. In particular, the Directive assigns a coordinating role to the consolidating supervisor, which is as a rule from the Member State where the credit institution or the financial holding company heading the group is based. The Directive also strengthens and clarifies the requirements for information-sharing and cooperation between all the authorities responsible for the supervision of the entities comprising the banking group. Moreover, it requires the competent supervisory authorities to have written coordination and cooperation arrangements in place.

Regarding the provisions of the CRD which are relevant for crisis situations, Article 130 of the CRD requires the consolidating supervisor to alert central banks and ministries of finance as soon as is practicable in the event of an emergency which threatens the stability of the financial system of a Member State. Article 132 sets out a number of provisions which impose the obligation for the competent supervisory

authorities to cooperate closely and to share information which is essential or relevant for the exercise of their respective tasks. In particular, information shall be regarded as essential if it could materially influence the assessment of the financial soundness of an institution in another Member State. Furthermore, adverse developments in credit institutions or in other group entities that could seriously affect the credit institutions will be considered as essential information to be shared between the supervisory authorities.

The practical application of the CRD provisions is also supported by the development of guidelines by the CEBS.<sup>12</sup> These guidelines provide concrete guidance for the effective and consistent implementation of the revised legal framework for cross-border banking groups, and enhance the practical operational networking of national supervisors. They have been developed following a risk-based and proportional approach. For instance, the degree of information exchange and cooperation between supervisors should be related to the systemic relevance of the entities, both in relation to the host local market and the group as a whole.

The concrete application of the CRD provisions in the area of crisis situations will benefit from as well as complement the procedures envisaged in the 2003 and 2005 MoUs described above. These provisions support the overall interaction between all the authorities potentially involved in a crisis situation.

Regarding the specific context of crisis management, currently the BSC and the CEBS are jointly working on the central banking and supervisory practices for handling financial crises at the cross-border level, in order to enhance the operational effectiveness of the existing arrangements.

<sup>12</sup> The guidelines are available from the CEBS website: <http://www.c-ebs.org/>

**THE FINANCIAL CONGLOMERATE DIRECTIVE**

The intensification of cross-sectoral links in the European financial landscape is also reflected in the emergence of financial conglomerates, which combine regulated entities from the insurance sector and either the banking or securities sectors. Financial conglomerates are subject to a specific regulatory framework with the adoption of the Financial Conglomerates Directive (FCD) in December 2002, which introduces the *supplementary* supervision of the regulated entities comprising a financial conglomerate operating in the EU.<sup>13</sup>

The FCD sets out requirements for information sharing and cooperation among the supervisors of the regulated entities in a financial conglomerate. In particular, the Directive provides for the identification of a supervisory authority as coordinator of the supplementary supervision of the financial conglomerate, to manage these tasks. The Directive also includes provisions organising the way in which this coordinator supervisor exercises its responsibilities, which is similar in some aspects to the concept of the consolidating supervisor as set out in the CRD, but falls short of full consolidation across sectors.

The FCD also introduces a number of provisions that are relevant to crisis management. In particular, in accordance with Article 11 of the Directive, the tasks to be carried out by the coordinator supervisor include the coordination of the gathering and dissemination of relevant or essential information in going-concern and emergency situations, including the dissemination of information which is of importance for a competent authority's supervisory task under sectoral rules.

Furthermore, as in the CRD provisions mentioned above, the competent authorities responsible for the supervision of regulated entities in a financial conglomerate are obliged to cooperate closely with each other. This entails in accordance with Article 12 of the Directive the gathering and the exchange of

information with regard to adverse developments in regulated entities or in other entities of the financial conglomerate which could seriously affect the regulated entities, among other aspects. Information may also be shared with central banks, as it may be needed for the performance of their respective tasks.

**CENTRAL BANKING ARRANGEMENTS**

In the case of a potential crisis situation, central banks may play an important role in the context of their responsibilities as monetary authorities and overseers of payment systems, as well as in their overall responsibility for contributing to the stability of the financial system as a whole.

In particular, the exercise of these responsibilities allows central banks to detect warning signs or disturbances at the level of liquidity in money markets and payment systems that could materialise into crisis situations. In addition, central banks may assess the systemic implications of a financial disturbance or crisis in terms of its impact and potential spillovers to financial institutions, markets and infrastructures.

The responsibilities of central banks also allow for the deployment of certain tools which may contribute to the management of a crisis situation. These tools include actions concerning general liquidity conditions, the functioning of market infrastructures, and other possible interventions which could help restore orderly market conditions.

One of the specific tools available to central banks in a crisis situation is the provision of emergency liquidity assistance (ELA) to individual banks. Generally, this tool consists of the support given by central banks in

<sup>13</sup> Directive 2002/87/EC of the European Parliament and of the Council of 16 December 2002 on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate; this amended Council Directives 73/239/EEC, 79/267/EEC, 92/49/EEC, 92/96/EEC, 93/6/EEC and 93/22/EEC, and Directives 98/78/EC and 2000/12/EC of the European Parliament and of the Council.

exceptional circumstances and on a case-by-case basis to temporarily illiquid institutions and markets. This support may be warranted to ease an institution's liquidity strains, as well as to prevent any potential systemic effects, or specific implications such as disruption of the smooth functioning of payment and settlement systems. However, the importance of ELA should not be overemphasised. Central bank support should not be seen as a primary means of ensuring financial stability, since it bears the risk of moral hazard. Furthermore, ELA rarely needs to be provided, and is thus less significant than other elements of the financial safety net, which have increased in importance in the management of crises.

The cooperation between EU central banks in crisis situations at the cross-border level will be facilitated, where warranted, by the framework set out in the EU-wide MoU and in some of the regional MoUs described above. In particular, such procedures will support the sharing of information about emerging financial disturbances, the assessment of potential systemic implications, and the coordination, if deemed necessary, of policy actions between central banks, as well as between central banks and other involved authorities.

Within the specific setting of the Eurosystem, the necessary mechanisms to tackle a financial crisis are in place.

First, the Eurosystem has set up the appropriate operational procedures to contain within the scope of its functions the potential implications of a financial disturbance. This includes procedures for the conduct of monetary policy operations, the oversight of payment systems also considering potential consequences for the operation of market infrastructures, and the safeguarding of financial stability. In this context, the committees established under the Eurosystem to assist its work and advise the decision-making bodies may also support the operational handling of a potential disturbance.<sup>14</sup>

Second, the Eurosystem also has procedures in place regarding the provision of ELA by the individual Eurosystem NCBs. Since ELA is not a Eurosystem function, the decision concerning its provision lies with the competent NCB regarding an institution operating in its jurisdiction. The Eurosystem procedures ensure an adequate flow of information so that any potential liquidity impact can be managed in a manner consistent with the maintenance of the appropriate single monetary policy stance. These procedures on ELA are internal to the Eurosystem, but their smooth functioning is also linked to the wider arrangements at the EU level for dealing with the cross-border implications of financial crises.<sup>15</sup>

## SIMULATION EXERCISES

This Special Feature has provided an overview of the EU arrangements for addressing potential financial crisis situations, which may involve cross-border spillovers in more than one Member State. In particular, the arrangements include a number of tools which support the cooperation between authorities in such situations. Like any tool, these arrangements are likely to become more effective as authorities become more familiar with their functioning.

To enhance understanding of the practical implementation of the EU arrangements, the authorities have organised financial crisis simulation exercises. The basic aim of these simulation exercises is to replicate, to the extent possible, crisis scenarios that will help them understand how the arrangements will assist in practice with the management of a real-life crisis situation. In this sense, crisis simulation exercises may also develop the preparedness of authorities for cooperation in crisis management. In line with the scope of the arrangements described in this Special Feature, financial

<sup>14</sup> Among the committees assisting the work of the decision-making bodies of the ECB, the Market Operations Committee (MOC), the Payment and Settlement Systems Committee (PSSC) and the BSC are those which could be more directly involved in financial crisis management.

<sup>15</sup> See ECB (1999), *Annual Report*.



crisis simulation exercises have taken place at the domestic, regional and EU levels.

At the EU level, financial crisis simulation exercises have been organised to test the effectiveness of the overall financial stability arrangements. The first such exercise took place in September 2003 under the aegis of the BSC, and aimed at testing the provisions of the 2003 MoU. This exercise provided useful insights into the different aspects of cross-border cooperation between banking supervisors and NCBs in the event of a systemic financial crisis.

A recent EU-wide financial market crisis management simulation exercise took place in April 2006 under the aegis of the EFC, and aimed at testing the 2005 MoU mentioned above. The exercise involved representatives from all the EU banking supervisors, central banks and finance ministries. Generally, the exercise indicated that relevant Member State authorities were able and willing to cooperate in managing cross-border systemic financial crises. The exercise also provided a number of useful insights on how to improve further the management of cross-border crises increasing

the overall level of stability in the single European financial market. To this end, the ECOFIN Council agreed on further work for enhancing cooperation among Member State authorities responsible for financial market stability.<sup>16</sup>

In the context of the Eurosystem arrangements for financial stability, the Eurosystem central banks have also carried out financial crisis simulation exercises relating to the ability of the Eurosystem to address effectively a financial crisis with the potential for systemic implications across several countries in the euro area. The most recent exercise took place in May 2006.<sup>17</sup>

The exercises involved all the relevant central banking functions, including the conduct of monetary policy operations, the oversight of payment systems also considering potential consequences for the operation of market infrastructures, and the safeguarding of financial stability. Given the high degree of financial integration within the euro area, the exercises placed particular emphasis on the

16 [http://www.eu2006.fi/calendar/vko36/en\\_GB/1129708439336/?calYear=2006&calMonth=8](http://www.eu2006.fi/calendar/vko36/en_GB/1129708439336/?calYear=2006&calMonth=8)

17 See the related press release available at [www.ecb.int](http://www.ecb.int)

**Table E.1 Overview of the EU framework for financial crisis management**

	Authorities responsible for financial stability		
	Central banks	Banking supervisors	Finance ministries
Regulatory arrangements	Capital Requirements Directive (CRD)		
	Financial Conglomerate Directive (FCD) <sup>1)</sup>		
Voluntary cooperation arrangements	2005 MoU on crisis management		
	2003 MoU on crisis management		
	2001 MoU on payment systems		
	Regional and bilateral MoUs <sup>2)</sup>		
	Domestic MoUs <sup>2)</sup>		
Central banking arrangements	Eurosystem		
EU committees	BSC and CEBS		FSC
	EFC		EFC
Tools for practical implementation	Financial crisis simulation exercises		
	Development of practices by EU Committees		

1) The exchange of information between supervisory authorities and finance ministries regarding the regulated entities of a financial conglomerate is subject to the sectoral rules in EU legislation for credit institutions, insurance companies and securities firms.

2) Regional and domestic MoUs may involve different sets of authorities, including either or both central banks and banking supervisors. In some Member States, finance ministries are also parties to MoUs.

systemic interlinkages between the components of the financial system, including institutions, markets and market infrastructures, both on a national and on a cross-border basis. The conduct of the exercises confirmed the preparedness of the Eurosystem to deal with potentially systemic events that could affect the financial system of the euro area.

### CONCLUDING REMARKS

Since the introduction of the euro, the debate regarding the adequacy of EU institutional arrangements for financial stability has focused on the capability of a setting mostly based on the exercise of national responsibilities to prevent and manage crises in increasingly integrated financial markets. The reflections undertaken by the relevant fora, notably the EFC, have led to a series of recommendations which provided the basis for a significant enhancement of the EU's framework for financial crisis management.

Overall, it may be concluded that, since the introduction of the euro, the EU arrangements for financial crisis management have been subject to a comprehensive review. The guiding principle was acknowledging the potential of the current institutional set-up for handling crises effectively, while introducing procedures aimed at supporting the interaction between the different sets of authorities. These procedures also take account that authorities, in the context of their responsibilities, should retain the necessary discretion and flexibility to tackle the specific aspects of a potential crisis situation. The particular enhancements consisted of a number of initiatives aiming at further strengthening co-operation and co-ordination between the responsible authorities in order to ensure the effective safeguarding of financial stability in the single financial market. This involved measures of different nature, including legislative initiatives, voluntary cooperation agreements, and the reinforcement of the practical application of the overall framework for financial crisis management. Moreover, the enhancements were implemented

taking account of the different dimensions of cooperation, namely at the domestic, regional and EU levels.

In this context, the approach followed thus far has the merit of providing a comprehensive multi-layered and flexible framework at the EU level, which has the potential to adapt swiftly to the specific challenges that a crisis situation may raise for the responsible authorities, particularly in terms of coping with potential cross-border spillovers. In addition, such a framework is also open to further practical refinements in particular areas, as it may be considered necessary in view of developments in the financial landscape. In addition, the periodic assessment of the effective functioning of the institutional arrangements for crisis management – also through the conduct of further financial crisis simulation exercises at EU level – may also provide the basis for such refinements. In this direction, the recent conclusions of the Ecofin Council in Luxembourg of 10 October 2006 underlined that efforts should be continued to further deepen the co-operation among relevant authorities and ensure that EU arrangements for financial stability correspond with the developments in the financial markets. Accordingly, the Ecofin Council invited the EFC to further develop procedures and, as appropriate, general principles for resolving cross-border financial crises in the EU and to report back to the Ecofin Council on these issues semi-annually.