EUROPEAN CENTRAL BANK

OPINION OF THE EUROPEAN CENTRAL BANK

of 18 September 2002

at the request of the Finnish Ministry of Finance
on a draft proposal concerning a revision of the Act on the
Financial Supervision Authority

(CON/2002/23)

1. On 22 July 2002 the European Central Bank (ECB) received a request from the Finnish Ministry of Finance for an opinion on a draft government proposal concerning a revision of the Act on the Financial Supervision Authority and certain other related acts (the 'proposal'). The proposal intends to replace the existing Act on the Financial Supervision Authority *(Rahoitustarkastuslaki 503/1993)* by a new Act and, as a result, make technical amendments to the other acts.

   The new Act would explicitly state the objective and duty of the Finnish Financial Supervision Authority (FSA), which are lacking in the existing Act. It would also amend and supplement the provisions concerning the operating methods of the FSA in order to take into account substantial changes taking place in financial markets and in the supervision thereof. In particular, the competence to grant or withdraw the operating licences of some supervised entities would be transferred from the Ministry of Finance to the FSA. The proposal would also widen the existing powers of the FSA to impose sanctions on supervised entities. According to the proposal, the revised operating methods as well as new powers regarding sanctions would have to be reflected in the rules concerning decision-making and management of the FSA which are therefore revised.

2. The ECB's competence to deliver an opinion is based on Article 105(4) of the Treaty establishing the European Community and on the sixth indent of Article 2(1) of Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions[1], as the proposal contains provisions on rules applicable to financial institutions insofar as they materially influence the stability of financial institutions and markets. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council of the ECB has adopted this opinion.

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1 OJ L 189, 3.7.1998, p. 42.

3. The objective of the FSA. The definition of the objective of the FSA in the new Act would not change the existing status of the FSA as an entity operating in connection with Suomen Pankki. According to the proposal, the objective of the FSA would be the '*maintenance of public confidence in the operation of financial markets*'. The ECB would like to recall in this context Suomen Pankki's responsibility concerning contributing to the reliability and efficiency of the overall financial system in Finland, according to Section 3 of the Act on the Bank of Finland (*Laki Suomen Pankista 214/1998*).

   The ECB welcomes the fact that the proposal contains for the first time an explicitly stated objective of the FSA. This would usefully increase transparency and improve market perception of the functioning of the FSA. However, the ECB would like to note that the exact formulation of the objective could be very important regarding such perception of how it operates. From this perspective, the ECB would like to make two observations. First, the objective should preferably contain a direct reference to the maintenance of financial stability, in addition to the maintenance of confidence in the financial system. It is important to emphasise the maintenance of financial stability, since this conveys the idea that the objective is not to ensure the operation of all individual financial institutions in all eventualities, but the overall stability of the financial system. This would emphasise the importance of effective market discipline (including possible failures of entities in these markets) and the responsibility of financial institutions themselves for adequate risk management. These considerations reflect internationally approved views on the objectives of financial supervisors[2]. Second, the objective as proposed could give the impression that the FSA is the only authority in Finland contributing to financial stability and confidence in the financial system. Hence, the proposal could state that the objective of the FSA is to maintain, for its own part and in cooperation with other relevant authorities (including Suomen Pankki), stability and confidence in the financial system.

4. Licensing powers of the FSA. The proposal would amend and supplement the rules concerning the operating methods of the FSA. In particular, the proposal would grant the FSA the competence to grant or withdraw the operating licences of credit institutions, investment services companies and pawnbrokers. Under the existing Act on the Financial Supervision Authority this competence belongs to the Ministry of Finance. While the transfer of such licensing powers to the FSA would significantly enhance its competence, a number of other supervised entities operating in the securities markets would continue to be licensed by the Ministry of Finance. It would remain the competent authority to license, inter alia, banking and deposit guarantee funds, investor compensation funds, the stock exchange, clearing companies and the central securities depository.

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2 See especially the 'Core Principles for Effective Banking Supervision' issued by the Basel Committee on Banking Supervision (September 1997). For instance, the principles state that '[*s*]*upervision cannot, and should not, provide an assurance that banks will not fail. In a market economy, failures are part of risk-taking*'.

The ECB welcomes the proposal that licensing and supervision responsibilities be combined and allocated to the FSA. This supports the effective conduct of supervision as the control of market entry and of on-going businesses are held by the same authority, which can also withdraw licences as an ultimate sanction[3]. However, the ECB would like to note that the reasons for maintaining the separation in the licensing and supervision of some entities, as mentioned above, are not very clearly stated in the proposal. Apart from ensuring effective supervision, having all licensing powers regarding different, but closely linked, securities market participants allocated to a single authority could also enhance the level playing field. When separation exists, cooperation between the licensing authority and the supervisor has to be assured.

5. Sanctioning powers of the FSA. In order to strengthen the efficiency of supervision by the FSA and shift its emphasis towards early intervention and more pre-emptive measures, the proposal would widen the range of sanctions available to the FSA to include, in addition to existing sanctions, a 'public reprimand', a 'public warning' and an 'administrative fine'. A public reprimand would be issued if a supervised entity is in breach of an act, regulation or guideline applicable to it, for example if a supervised entity does not fulfil its reporting obligations to the FSA. A public warning would be issued if this conduct is repeated or if a public reprimand was not deemed sufficient. An administrative fine of up to 50 000 EUR could under certain circumstances be imposed in addition to a public reprimand or warning.

   The ECB very much welcomes the enhanced sanctioning powers of the FSA, as they also form an integral element of effective supervision[4].

6. Decision-making bodies of the FSA. The proposal would also revise the existing provisions concerning decision-making and management of the FSA to ensure that its operation is in line with its new powers. The proposal includes an amendment to the effect that the Director General of the FSA would cease to be a member of its Board. The Director General would attend Board meetings as a permanent expert advisor without any voting rights. The Director General would be responsible for managing the FSA and ensuring that it performs its duties efficiently and economically in accordance with its guidelines. The Board of the FSA would set its aims and orientations, adopt guidelines, instructions and interpretations on matters that are significant in principle. In addition, the powers of the Board would be strengthened in relation to the core supervisory activities of the FSA, including the new powers contained in the proposal. The Board would, for example, decide on granting licences and imposition of sanctions. The oversight of both the Director General and the Board remains with the Parliamentary Supervisory Council, the role of which would be somewhat strengthened by the proposal.

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3 See also Principles 2 and 3 of the Core Principles for Effective Banking Supervision (op. cit.).

4 See also Principle 22 of the Core Principles for Effective Baking Supervision (op. cit.).

The ECB supports the more clearly specified and strengthened decision-making structure of the FSA as regards the strengthening of the role of the Board in steering its general functioning. However, the ECB would like to note that in light of the enhanced powers of the Board of the FSA and its revised composition it might be appropriate to insert an explicit provision according to which the members of the Board of the FSA are required to act in their personal capacity.

In addition, the ECB would like to note that it should be ensured that the Board has adequate expertise to carry out its decision-making tasks. In view of this consideration, maintaining the status of the Director General as a full member of the Board is likely to increase the quality of the decision-making process. It could also increase the acceptance and credibility of the decisions in the market place and possibly also the commitment of the FSA to implement the decisions.

7. The ECB confirms that it has no objection to the competent national authorities making this opinion publicly available at their discretion.

Done at Frankfurt am Main on 18 September 2002.

The President of the ECB

[signed]

Willem F. DUISENBERG