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SAFETY NET IN THE EUROPEAN UNION – CHALLENGES FOR NEW MEMBERS

The paper is devoted to the safety net in the European Union with special interest on issues important for the new EU Members. The author analyzed the current structure of the safety net in 25 countries and pointed out the differences and the weaknesses of certain solutions. This analysis is followed by the presentation of the possible future scenarios of the changes in the safety net with the stress on the need to reduce the potential for contagion effect.
Keywords: regulation, supervision, deposit guarantee, financial stability

INTRODUCTORY REMARKS

There is no consensus in the economic literature how to regard a safety net. Is that a remedy for keeping banks safe and sound or is that a poison for the market power and its philosophy. Here we treat the safety net as a fundamental part of the financial infrastructure and we are not going to discuss the pros and cons for establishing it. In most countries around the world the existence of the safety net is a fact. Though we need to keep in mind that a safety net for banks is difficult to design and administer because it has the conflicting objectives of protecting bank customers and reducing banks' incentives to engage in risky activities (Demirguc-Kunt, Huizinga, 2000). This is also the case in the enlarged European Union, where safety nets in all 25 countries are designed differently and particular countries may have different priorities for the future solutions in that area.

The safety net is defined here as all the institutions and regulations established to limit the risk in the sector of the financial intermediaries (within banks). It embraces central bank (only for banks) as the lender of the last resort, regulatory and supervisory authorities (in the case of integrated supervision – an authority) to safeguard safety and soundness, as well as consumer protection schemes (in the case of integrated protection – a scheme) to maintain consumers confidence in the providers of financial services.

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The purpose of this paper is to review the current structure of the safety net across EU countries and discuss the best solutions for the future integrated European market with special attention to the banking sector and with a stress on the problems that new EU member countries may face. The structure and role of the central banks, although they are an important part of the safety net, shall not be discussed here, since their task to provide liquidity is explicitly defined and compatible in EU-25.

1. CURRENT STRUCTURE OF THE SAFETY NET

Below we shall elaborate on the structure of the supervisory and regulatory authorities as well as the structure of the consumer protection. In both areas, banks shall be treated as the leading financial intermediaries, since their stake in financial services market is prevailing. Thus the main focus will be on the solutions applied for banks.

1.1. Supervision and regulation

Supervision and regulation over banking activities in the EU are based on three pillars (Welteke, 2000):

- harmonization of the prudential regulations,
- assigning the authority to supervise banks at national level,
- bi- and multilateral co-operation.

We used the notion „supervision and regulation over the banking activities" instead of "banking supervision and regulation". It was aimed at stressing that in many EU countries there is an integrated supervision over the financial market and financial intermediaries (banks, insurers, brokers, asset management companies). Due to the fact that banks are performing within the holding structures, the assessment of the banks' safety and soundness should be conducted together with the assessment of other institutions being a part of the holding in order to avoid or minimize the contagion effect. The contagion effect consists of transmitting some turbulence from one country to the other (cross-border contagion) or from one entity from a certain sector to another in the same sector (intra-sector contagion) or between different sectors (cross-sector contagion). The development of the credit derivatives and

securitization caused that the most important banking risk – the credit risk – was also transferred to other financial intermediaries.

Both at the European (Kremers et al, 2003 and Heinemann, Schüler, 2002) and local (Pawłowicz, 2003) levels there are discussions on the future of the supervision over banking activities and the regulation of multinational banks (Calzolari, Loranth, 2005). The main question is whether the integrated financial market in the EU should be supervised at a local level or should there be a pan-European supervisory body. Another question is how to protect consumers in the integrated financial market in order to reduce home and host country conflicts (Eisenbeis, 2004).

Answers to these questions are extremely important both for new EU member countries and for the accessing countries. The reason is quite simple – the share of foreign capital in financial sectors (banks, brokerage, insurance) of these countries is significant. E.g., in Poland foreign investors control about 65% of banking sector's assets, in Lithuania – 78%, but in Estonia – 99% (for further details see table 1).

Table 1

Assets in financial sectors controlled by foreign capital in selected EU countries

Country	Assets controlled by foreign capital (%)
Denmark	0
Finland	6
Germany	4
Great Britain	46
Greece	11
Italy	6
Luxemburg	95
Netherlands	2
Portugal	18
Spain	9
Cyprus	13
Estonia	99
Hungary	89
Lithuania	78
Poland	65
Slovenia	21

Source: Schoenmaker, Oosterloo, September 2004

Since the intra-sector (e.g. banking) regulations are harmonized, this is only to mention that there is a kind of European "passport" and many regulations related to risk-taking and risk monitoring. The European passport means that if the licence is issued by any local authority, any

financial intermediary could provide services via branches set up in other countries or on a cross-border basis. The most important regulations regarding banks are defined in Directive 12/2000 and CAD, i.e. exposure limits and capital adequacy. Due to the adoption of Capital Requirements Directive (CRD – this is Basel II transposition into the European regulatory framework) by the European Parliament in September 2005, these Directives were amended. CRD will come into force from 1 January 2007.

More important seems to be the structure of the supervision. In European countries there are three main types of the institutional form of the supervision (Iwanicz-Drozdowska, 2004):

- stand-alone (solo) supervision – each segment of the financial market has its own supervisory authority; the supervisory authority for the banking sector is either the independent institution or part of the central bank; co-operation among supervisors is possible;
- mixed supervision – the supervisory authority responsible for banks is also supervising other types of financial intermediaries, except insurance companies and similar; this supervisory authority is either an independent institution or is a part of the central bank; co-operation with other supervisors is possible;
- integrated supervision (one supervisor for the whole financial market), which is either the independent institution or is a part of the central bank.

In 7 out of 15 "old" EU member countries there is the integrated supervision model (Austria, Belgium, Denmark, Germany, Ireland, Sweden, United Kingdom, table 2). This type of supervision is gaining in popularity. In the last few years such type of supervision was introduced in 4 countries (Austria – 2002, Belgium – 2004, Germany – 2002, Ireland – 2003). In the remaining "old" EU member countries there are mixed supervisors within the central banks. An interesting example is the Netherlands, where in 2004 the responsibility for the prudential supervision of financial intermediaries (are the financial intermediaries reliable?), except insurers and pension funds (institution responsible for their supervision is Pensioen- & Verzekeringskamer), was assigned to the central bank, while the authority for supervising the conduct of business (are the financial intermediaries managed in a proper way and do they have proper information at disposal?) was left in the hands of a separate institution (Autoriteit Financiële Markten).

Among 10 new EU member countries the stand-alone supervision being a part of the central bank is prevailing (6 countries: Cyprus, Czech Republic, Lithuania, Poland, Slovak Republic, Slovenia). In other new member countries there are integrated supervisors located within the central bank (except Estonia).

Table 2

Types of supervision over the banking activities in the EU countries

Type of supervision	Number of "old" EU countries	Number of "new" EU countries	Total number
Solo (stand-alone)	-	6	6
Mixed supervision	8	-	8
Integrated supervision	7	4	11

Source: central banks' and supervisory authorities websites; own preparation

According to our previous research (Iwanicz-Drozdowska, 2004) the structure of the financial market was not determining the type of supervision. For example, in such countries like France and the Netherlands where the insurance market is very well developed there was a mixed supervision. While the integrated supervision model was applied in those countries where the insurance market was not so strong.

As pointed out above, the institutional form of supervision over the banking activities varies across the EU countries. This creates an obstacle to introducing a uniformed and centralized form of supervision over the banking activities and – in a broader sense – over the whole financial market. However, the institutional structure of the safety net is not the only barrier for setting up pan-European supervision over the financial market. Beside institutional harmonization there are the following (Iwanicz-Drozdowska, 2004):

- regulatory – standardized prudential regulations;
- analytical – a standardized method of assessing banks in order to undertake appropriate actions in a clear and unequivocal manner;
- information – a standardized manner of informing market participants about the condition of the banking sector.

As mentioned before, the level of the regulatory intra-sector harmonization is high, although Basel II (CRD) may introduce some disruptions because of the space left to supervisors for introducing

locally-oriented solutions. The cross-sector harmonization is low due to the fact that the way in which the risk is addressed in insurance business is not comparable to that used for the banking sector and investment companies. In order to achieve the higher level of harmonization it will be necessary to create measures of financial risk comparable between individual sectors of the financial market, which would facilitate a creation of a standardized manner of measuring capital adequacy and exposure limits. Solvency II – a project to measure the solvency in the insurance sector in a way similar to Basel II is a good starting point. According to the recent agenda, it will come into force in 2010.

The level of both analytical and information harmonization was assessed as low. In order to properly execute supervision it is necessary to increase analytical harmonization, which would facilitate a comparable assessment of individual institutions, as well as the financial conglomerates. It is particularly important to standardize the evaluation grades, whilst standardizing the methodology of evaluation is up for discussion, providing the fundamental principles are the same.

It is difficult to talk about an integrated financial market without uniform information about it. The *status quo* is not satisfactory in that field. The frequency of publication of information concerning the condition of the banking sector and other sectors of the financial market should be recommended at the EU level. The standardized manner of presenting this information as far as the basic data is concerned, i.e. financial profits, assets, shareholders' equity, etc. for the individual segments of the financial market is also necessary to increase its transparency.

1.2. Consumer protection

Consumer protection in the financial services industry should consist of protecting customers in the case of the failure of any financial intermediary (anti-bankruptcy protection). This requirement is fulfilled for the banking sector (deposit protection) and for investment companies (investors compensation). The situation is different in the insurance industry, in which anti-bankruptcy protection is rare and not formalized in EU regulations. As mentioned above, we shall focus on the solutions adopted for the banking industry as the main sector of financial intermediaries in Europe.

On 30 May 1994, the European Parliament and the Council passed the Directive on deposit guarantee schemes (94/19/EC). The main objective of this Directive was to protect throughout the European Union the depositors of all credit institutions and to safeguard the stability of the banking system as a whole.

The EC Directive set the minimum requirement for the deposit guarantee – 20,000 euros per depositor with at least 90% coverage from the scheme (i.e. up to 10% of depositor own responsibility, so-called co-insurance), the basic definitions and some organizational requirements for the scheme.

The most important issues regulated by the Directive are the following:

- Each Member State shall ensure that within its territory one or more deposit-guarantee schemes are introduced and officially recognized. The Member State may exempt a credit institution from entering into the deposit-guarantee scheme if the institution belongs to a system which protects depositors at least the same level.
- The schemes shall be in a position to pay deposits within three months from the date of declaring them as unavailable. In special cases this time limit may be extended to a maximum of three months.
- Some depositors or deposits may be excluded from the guarantees or enjoy lower ones. These are deposits e.g. from financial institutions, government and central administrative authorities, local authorities, pension and retirement funds, and credit institution's own directors, managers and holders of at least 5% of its capital, as well as non-nominative deposits.
- The credit institutions shall make available to present and future depositors the information necessary for the identification of the deposit-guarantee scheme by which the institution's deposits are covered.

The Directive regulated the fundamentals of deposit insurance, but there were several issues left to national regulators. This caused a wide variety of differences across countries, which is unfavourable from the financial market integration perspective.

There are two main aspects that should be identified from the consumer protection point of view, i.e. the level of protection and the reliability of the scheme (Iwanicz-Drozdowska, 2005).

Table 3

Level of protection and its relation to GDP

Country	Coverage limit to GDP per capita	Coverage limit in euros
Austria	72.75%	20,000
Belgium	76.90%	20,000
Cyprus	150.94%	20,000
Czech Republic	344.71%	25,000
Denmark	124.03%	40,363
Estonia	119.71%	6,391
Finland	91.41%	25,000
France	276.40%	70,000
Germany	77.51%	20,000
Great Britain	209.14%	52,000
Greece	144.72%	20,000
Hungary	341.92%	23,694
Ireland	67.90%	23,000
Italy	456.33%	103,291
Lithuania	333.31%	14,481
Luxembourg	38.34%	20,000
Latvia	231.32%	9,000
Malta	210.14%	20,000
Netherlands	71.29%	20,000
Poland	449.07%	22,500
Portugal	196.16%	25,000
Slovak Republic	402.67%	20,000
Slovenia	185.77%	21,282
Spain	109.77%	20,000
Sweden	98.39%	33,063

Source: Bank Guarantee Fund of Poland, Eurostat; own preparation

As presented above (table 3), the level of consumer protection differs among EU countries at both the nominal level and the relative level (to GDP *per capita*). In new EU Members the relative level of protection is high in comparison to most of the highly industrialized EU-15 countries. In October 2004, the European Commission opened the discussion on the scope of the review of the Directive. The obligatory item for review is the level of the guarantees. Even without the in-depth analysis of the data included in table 3, let us draw a conclusion that it would be difficult to find a new optimal level of guarantees. New EU countries have coverage higher than twice GDP *per capita* (277% for EU-10). Additionally, three Baltic States enjoy a transitional period for reaching a 20,000 euros limit (till the beginning of 2008). It seems that from the consumer protection point of view "old" and "new" EU Members may have different objectives for setting the guarantee limit.

Table 4

Some features of the deposit guarantee schemes in the EU

Countries	Number of risk minimizer schemes	Number of schemes with ex ante funding	Number of schemes with risk-based premiums
EU – 25, and within:	8	18	6
EU – 10	2	8	0

Source: Bank Guarantee Fund of Poland; own preparation

The reliability of the deposit guarantee scheme may be linked to its financial strength and powers. The financial strength is based on:

- the type of financing – *ex-ante* (funds accumulated by the guarantee scheme) or *ex-post* (funds retained in banks, but being called upon in case of the bank's failure);
- the way of premium calculation – risk-based premiums (differentiated according to the risk of the individual banks) or flat premiums (not differentiated)

In UE countries the *ex-ante* financing is prevailing (see table 4). It was implemented in 18 countries, while mixed financing in 2 countries (Great Britain and Poland), and *ex-post* in 5 countries (Austria, Italy, Luxembourg, Netherlands and Slovenia).

For the financial stability and reliability of the guarantee scheme the desirable solution is *ex-ante* or mixed financing. Both of them allow accumulating certain financial resources for probable future deposit payouts. The financial strength of the guarantee scheme should be the focus for all the safety net players and the members of the scheme. It is also important for the guarantee scheme to have access to emergency financing (from the central bank or from the market). Explicit emergency financing is available in 20 out of 25 countries in the EU, except Italy, Luxembourg, Portugal, Slovenia and Sweden.

Both *ex-ante* and mixed financing require setting up a target fund, which varies across EU countries from 0.5% (Belgium) to 10% (Finland – Finland is not typical; the typical level of the target fund ratio is 3%) of guaranteed deposits. Sometimes the target fund is set in the nominal value (Denmark), which is rather less flexible.

The powers of the schemes also differ across countries. In 8 of them the schemes are risk-minimizers with the power to intervene and to minimize the risk for the guarantee scheme with the use of the least lost rule. Having such broad powers is an advantage for financial stability – even with some

limitations related to the moral hazard – due to the fact that there is an institution which has been assigned a task of supporting the financial restructuring of the bank. The opposite model of the powers is a pay-box system, responsible only for deposit payouts.

There is one more issue strictly connected with the reliability of the scheme, i.e. public awareness. Consumers need to be acquainted with the rules of consumer protection in the area of financial services. To this aim the guarantee scheme shall conduct proper information campaigns, not only at the beginning of its operations, but keep the customers informed permanently, especially in case of any changes in regulations.

In the case of investor compensation, regulation was adopted in 1997 (97/9/EC) and the level of coverage and principles of payout are similar to those presented for the banking sector. A different solution was adopted for the insurance industry. First of all, the EU regulations in that area regard only motor insurance (from Directive 72/166/EEC to 5th Motor Insurance Directive 2005/14/EC). The purpose of Motor Insurance Directives is to ensure the free movement of vehicles in the EU. To some extent those regulations protect consumers, but not in the anti-bankruptcy sense. They provide protection to victims of accidents, especially those caused by unidentified or uninsured vehicles. Only a few countries (Monkiewicz, 2005) provide anti-bankruptcy protection for the policy holder, at least for motor vehicles compulsory policies. In EU-15 these are: France, Great Britain and Spain. Such a solution was also adopted in Poland (for the coverage of life insurance policies as well). This situation creates an imbalance in the scope of consumer protection in certain segments of the financial market. Due to growing consumer awareness, the lack of coverage for life insurance policies in the case of insurer bankruptcy may reduce the share of this financial asset in the savings portfolio.

The institutional structure of regulation and supervision has been elaborated on in section 2.1. With reference to consumer protection schemes, the question arises if any changes are necessary in the future. First of all, we can state that the current institutional structure of the guarantee schemes is less developed (see table 5 for details) than in the field of the regulation and supervision. The assessment of being less developed is related to the evolution path of the financial market in the EU, which is to be the integrated one.

Table 5

Institutional structure of the guarantee schemes in the EU

Country	Stand-alone guarantee scheme	Mixed guarantee scheme	Integrated guarantee scheme
EU – 25, and within	18	6	1
EU – 10	8	2	0

Source: Bank Guarantee Fund of Poland; own preparation

There is only one integrated guarantee scheme in the EU (in Great Britain), but all around the world there are a total of two (except Great Britain also in Korea). Six schemes are mixed ones (i.e. combine deposit guarantee and investors' compensation). These are: Belgium, Denmark, Estonia (also pension funds), Lithuania, France and the Netherlands. In our opinion the institutional structure of the consumer protection shall be related to the structure of regulation and supervision in the integrated European financial market.

2. THE FUTURE AND THE CHALLENGES FOR THE SAFETY NET IN THE EU

J.M. Kremers et al (2003) defined the nine basis models for the supervision and regulation over the financial market, which is illustrated in table 6.

Table 6

Models of supervision over the financial market in the EU

Local cross-sector integration/ Cross-border integration	I. Sector	II. Cross-sector – functional*	III. Cross-sector – integrated**
A. Decentralization and co-operation	Co-operation in sector committees	Co-operation in functional committees	Co-operation among local integrated supervisors
B. Co-ordination	Co-ordination among local sector supervisors	Co-ordination among local functional supervisors	Co-ordination among local integrated supervisors
C. Centralization	European sector supervisors	European functional supervisors	European integrated supervision

* - means separate institution for prudential supervision and for the conduct of business

** - means one supervisory authority over the financial market.

Source: L. Pawłowicz, 2003, p. 40; own preparation

The above models could be treated as a framework for defining the future model of both supervision and consumer protection in the EU. The *status quo* for supervision is described by model A-I, but – as mentioned before – the integrated supervision model was applied in 11 out of 25 EU countries. So that is not a "pure" A-I model. After the adoption of the Lamfalussy process, co-operation on the EU level is a sector one:

- for the banking industry, it is the EBC (European Banking Committee) supported by the CEBS (Committee of European Banking Supervisors);
- for the capital market, it is the ESC (European Securities Committee) supported by the CESR (Committee of European Securities Regulators);
- for the insurance and pension fund industry, it is the EIOPC (European Insurance and Occupational Pensions Supervision Committee) supported by the CEIOPS (Committee of European Insurance and Occupational Pensions Supervisors).

Thus, there is an asymmetry between the integrated model at a local level and sector model of co-operation at the EU level in those 11 countries. The current structure of the supervision authorities in EU countries as well as co-operation at the EU level appear to be not adequate to the challenges which are deriving from the possible contagion effect, risk shifting and the integrated financial market.

In the case of consumer protection, *status quo* is also described by A-I, except Great Britain.

The fundamental question is what should be the target model for the safety net for the EU. Finding the right answer to that question is important for academics, bankers, as well as for decision makers. However, defining objective criteria for finding an optimal solution seems to be an extremely difficult task. As the history of banking and financial crises showed, most of the changes in the regulatory structure were introduced after any kind of unexpected event or shock. The European financial market has been stable for a very long time, except the cases of transformation crises in many EU-10 countries and some distress in the banking sectors in Spain, Finland and Sweden. Till now, there has been only one case of cross-border problem related to the BCCI affair, after which the Directive on consolidated supervision was adopted. Regulators and decision makers seem not to be willing to introduce any radical changes in the structure of the safety net because the current structure has not shown so far any major weaknesses.

As a proper criterion for assessing models described in table 6 we found the adequacy of the structure of the safety net to the structure of integrating financial market (1) on a cross-sector basis and (2) on a cross-border basis. There is also a limitation in the form of national interests. We need to point out that the goal is to address the problems that might occur in the future in the integrated financial market, especially in new member countries.

Only three out of nine basis models fulfil the criterion of adequacy on a cross-sector basis. These are: A-III, B-III and C-III. If the financial market in the EU is integrated on a cross-sector basis in the future, the only adequate structure is integrated supervision. The introduction of local integrated supervision and consumer protection in the EU would be consistent with the cross-sector integration of the financial market at the EU level. The target model for each country should then be the integrated supervision model, but the schedule for implementation should be adequate to the specific features and state of the local financial markets. The efforts make to centralize such a decision might destabilize the financial markets. Thus, the examination of the safety and soundness of the financial market as well as the quality of supervision in each segment of the financial market should precede the introduction of integrated supervision. Integrated supervision is essential due to the fact that banks – especially the big ones of systemic importance – are a part of the financial conglomerates. Types: A-II, B-II and C-II are less adequate to the integrated – on a cross-sector basis – financial market and types: A-I, B-I and C-I need to be rejected.

With regards to cross-border integration, the adequate models of supervision are: C-I, C-II and C-III. Less adequate are: B-I, B-II and B-III and the remaining models have to be rejected.

Table 7

Models accepted for cross-sector integration (striped) and for cross-border integration (gray)

A-I	A-II	A-III
B-I	B-II	B-III
C-I	C-II	C-III

Source: own preparation

According to our criteria, only C-III – European integrated supervisory body and consumer protection scheme – fulfils both of them. But this model would be very difficult to agree upon at the EU level. The principal obstacle is the political willingness to leave capital control over local financial markets to local capital. According to Boot (1999) the local financial

intermediaries are protected from take-overs by foreign capital. This is the case not only in those countries, where the governments commit easily on banking sector issues (e.g. France, Italy), but also in those where the government does not intervene in the banking sector (e.g. The Netherlands). This view is supported by the fact that cross-border mergers and acquisitions have been rather rare, except for the case of the Nordea group and Unicredito with HVB. Setting up a single supervisory authority would deprive the governments of the power to protect local financial intermediaries from foreign capital control.

National interests as a limitation undermine the arguments for C-III model implementation. Cross-border integration seems, in our opinion, to be more politically sensitive than cross-sector integration, upon which the market participants decide themselves. We decided to treat cross-sector integration as more important. Thus, for the medium-term perspective, the target model should be B-III – the co-ordination among local integrated supervisors and consumer protection schemes. This model seems to be a good compromise. It was adequate for cross-sector integration and less adequate for cross-border integration.

As pointed out before, in new EU member states the sector of financial intermediaries is controlled by foreign capital. From this perspective the most important factor affecting financial stability is the potential contagion effect. Is model B-III appropriate for minimizing the contagion effect?

The contagion effect should be analysed with regard to two types of shocks: macro (Staub, 1999) and micro (de Brandt, Hartmann, 2000). Macro-shocks are resulting from the economic downturn or other factors like: interest rates, foreign exchange rates, and prices of securities. Micro-shocks could be transmitted with the use of two channels, i.e. information channel (psychological contagion) or exposure channel in the inter-bank market or in the payment system (domino effect). One more channel should be identified, i.e. significant capital stakes' channel.

The cross-sector contagion is to result e.g. from using the same logo. The lost of trust could be transferred to other entities even if they are not "guilty" (psychological contagion).

According to Schüler (2002) the risk of cross-border contagion has considerably increased during the last 15 years in EU countries, which supports the idea of regulating and supervising financial market at the EU level. However, the author has not formulated any proposals.

In the case of cross-border contagion it is worth analyzing the capital stakes channels. The two types of risk of transferring that contagion shall be distinguished:

- subsidiary transferring risk to parent company,
- parent company transferring risk to its subsidiary.

The first type of risk has been already regulated at the EU level. There is a supervisory body responsible for the consolidated supervision of the whole group, and the supervisory authorities from the host countries are obliged to provide the home country supervisor with all the necessary information. The ownership structure in the financial intermediaries sector in new EU countries put pressure on the second type of risk. In Poland this problem was discussed mostly by Pawłowicz (2003), who underlined that there is a potential for the nationalization of losses and internationalization of profits.

None of the analyzed models is dealing *explicite* with the contagion effect, so we need to define additional instruments for solving that problem. One solution worth recommending is giving to the local (host) supervisors some additional tools to intervene if the financial standing or the activities of the parent company could destroy the situation of the subsidiary. To this aim, the local supervisors should have adequate access to information on the parent company and its risks.

The other solution is setting up a pan-European additional supervisory authority over the multinational financial holdings. This would be reasonable only in cases where the countries in which the foreign capital in financial intermediaries sector prevails had an adequate representation in decision making bodies in a position to protect their interests. In the case of lack of adequate representation this solution seems to be ineffective for new EU members.

The structure of consumer protection should follow the structure of supervision over the financial market also with special attention to the reduction of the contagion effect. To this aim, the review of home country and host country deposit guarantee schemes responsibility is necessary. According to the regulations in force, the home country deposit guarantee scheme is responsible abroad for deposit protection of all branches and not subsidiaries. In the case of contagion effect coming from the parent company, the deposit protection scheme in the country where the subsidiary is located has to pay for the contagion. So, the guilty party is shifting risk to the other parties. We shall revert to that issue later on.

Besides, there is an asymmetry in the scope to which consumers are protected in particular segments of the financial services market. This is the

case in the insurance market, where – according to EU regulations – no anti-bankruptcy protection is provided. First of all, this change shall be regarded as necessary for the integrating financial market. Leaving this difference unchanged may create a significant obstacle to the integration of consumer protection. Additionally, European company statutes may shine new light on consumer protection. If any bank (e.g. Nordea) decides to change its status into a European company, it might also move its headquarters to any EU country, which could be problematic for the local deposit guarantee scheme. In order to maintain financial stability, it would be reasonable to set up a complementary EU consumer protection scheme to protect in a proper manner the interests of the consumer and local markets.

After Financial Services Action Plan (FSAP), the European Commission issued in December 2005, after public consultation, a White Paper – Financial Services Policy 2005-2010. Four goals for the period 2005-2010 were defined there, among them the enhancement of supervisory co-operation and convergence in the EU. The commission put a stress on co-operation and not on changes in the regulatory structure. As written in the White Paper: "Any evolution of prudential supervisory structures in the EU away from the current arrangements raises difficult issues of political and financial accountability, especially when support from the public purse might be called upon. The Commission advocates an evolutionary approach, responding to demonstrated problems, striking the right balance between more efficient and consolidated supervisory arrangements and ensuring financial stability all over the EU."

As noticed, any significant changes are implemented after an unexpected event or shock. It seems that they could be introduced only in an evolutionary way with many political influences to protect national interests. With reference to the national interests there is an important question of covering the cost of a possible crisis. So far, any banking or financial crisis has been of a local (national) character. There was no real evidence of a contagion effect in the EU, so each country covered the costs of its own crisis. But how should costs be distributed in case of a contagion effect? That problem has not been addressed properly so far. In the European Commission White Paper (2005), it was only mentioned that „co-operation in a crisis situation has to be secure". Such a general remark is the continuation of a general description of crisis management in the memorandum of understanding (signed on 14 May 2005) on co-operation between banking supervisors, central banks and finance ministries of the European Union in financial crisis situations. The MoU is not a binding act,

but the interested parties avoided mentioning any problem of cost sharing. The only details relate to the principles and procedures for sharing information, views and assessments. The question of sharing the cost of financial crisis is especially important for new EU members, given the high share of foreign capital. New EU members shall raise this problem at the EU level and work for setting more detailed rules for crisis management. Putting the supervisory structure aside, the rules of cost sharing shall identify the guilty party who caused the contagion. Countries absorbing foreign capital have – under the current regulations – no instrument to intervene. The possible consequences shall be covered, but there is an open issue – by whom – by the guilty party or the affected country. According to Ch. Goodhart's proposal (2004), the European Central Bank might develop a role as an independent, unbiased and expert arbiter on handling such financial crises. The idea to assign this responsibility to the ECB seems reasonable, but this solution or any other to define the rules for cost sharing requires political willingness to do that before any real contagion effect occurs. This is extremely important for EU-10 countries in order not to be left alone in the case of the contagion.

CONCLUDING REMARKS

The future structure of the safety net in the EU will be the result of political compromise. The integration of the financial market will not be complete without changes in the structure and philosophy of the regulation, supervision and consumer protection. In this paper we tried to present the current structure of the safety net, its weaknesses and possible solutions for strengthening it in the future. Special attention was paid to the situation of the new EU member countries, where foreign capital is controlling a significant part of the sector of the financial intermediaries. In those countries there is a potential for a contagion effect deriving from parent companies via the capital stake channel. In order to reduce the likelihood of such contagion, the supervisory authorities should be granted new instruments and powers. This is also important for the consumer protection and its costs.

Recent years showed that the European financial market is stable, so the decision makers have no incentive to solve the problem of crisis management, especially cost distribution. However, this period of stability seems to be a very good time for discussions involving academics, at the local, regional and European levels.

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