

The Integration of the Regulation and Supervision of Financial Markets and the Possibilities of its Practical Implementation

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Abstract

The development of financial markets is to an increasing extent currently characterized by their interior and exterior integration, internationalization, evolution of a number of new highly sophisticated financial instruments, especially in the segment of financial derivatives, increasing securitization and creation of very complex international financial structures and financial flows within their framework. At the same time the necessity of restoring free market competition, growing volatility of monetary and financial quantities, institutionalization and intellectualization is more and more intensively discussed. Understandably, both regulation and supervision of the markets have to adapt to these objectively existing trends, including the growing call for increasing the efficiency of all activities. The integration of relations and processes carried out in financial markets requires a similar integration of relations and processes in the sphere of their regulation and supervision. However, there are a number of features of "lower level objectivity" or specific subjectivity and other characteristics functioning in this sphere which modify the implementation of the above mentioned trend, both in terms of depth and width of its intention and especially in terms of its concrete shape. The level of accepted specifics should never impair the very substance of the integration trend. That is the problem dealt with in the presented contribution

Key words: Financial markets; Integration tendency; Regulation and supervision; Specifics of integration of regulation and supervision

1. Introduction¹

Recent research in the field of regulation and supervision of the financial market is aimed at finding and defining theoretical and methodological bases for analysing existing systems and basic relations between the development stage of this market and corresponding system of regulation and supervision, so as to ensure the optimum and efficient range of these activities while respecting acceptable costs, and lastly to define quality and quantity criteria for efficient operating, and with their help theoretically specify the optimum organizational structure of the systems.

It is necessary for the effort and the possibility of their realization to be based and consequently elaborated respecting deep and valid knowledge of objectively working trends, which objectively define the content and scale of relations and processes, subjects and objects which should exist and work in this sphere, but also their form and ways of their realisation. It is essential, in accordance with these efforts, chosen starting points and model forms of relations, processes, subjects and objects created on their base, to compare their identity with or differences from the forms of their real application. The possibility of such comparison and the level of its application is of course directly connected with the level of the knowledge of reality, with the feasibility of settled objectives and last but not least with the possibility of suggesting changes within the existing form and, in case of consensus with their principle and form, of their subsequent realization. Regarding the enormous complexity, relevance and expensiveness of everything happening in the mentioned sphere it is very difficult to come to such

¹ The contribution has been made within the grant project: "Theoretical and methodological bases for the analyses of the systems of regulation and supervision of financial markets", for which the author has got a grant from the Grant Agency of the Czech Republic.

consensus and therefore it is essential to pursue all partial steps with maximum prudence and coordination. Both the factual and time demands are significantly increasing at present time characterised by globalization, internationalization, integration, intellectualization, institutionalization and who knows what else. Existing dimensions are becoming almost automatically totally different, and misunderstanding or even neglect of the fact is, in my opinion, unacceptable and could result in serious problems.

Another partial issue, though a very relevant one, to be solved today within the studied area is the issue of integration of the regulation and supervision of the financial markets. Objective changes in market economies unconditionally necessitate corresponding changes in the system of regulation and supervision of financial markets. Such changes have already been implemented in a lot of countries with more advanced financial markets than those in the Czech Republic, and here I mean especially EU member countries. In our country such changes are in preparation. It is impossible not to point out that it is the preparation, namely a significant change of its course and results which took place a few weeks ago, that made me accelerate the elaboration of my views on it. I am convinced that it is not positive change, but on the contrary that there are a lot of risks which can have negative impacts. The effort to avoid them is thus one of the basic reasons for writing this article.

2. Systems of regulation and supervision and efforts of their optimization

The article would not be complete without at least a very brief remark² concerning the systems of regulation and supervision, their classification, main types and the effort to optimize them and thus ensure the most efficient meeting of their basic objectives and tasks.

The existing development of the regulation and supervision is connected with a vast set of specific systems showing a lot of differences and diversities. Besides the differences, different systems have as well a lot of identical and general characteristics, e.g. the basic objective of regulation and supervision, which can be understood as the preservation of the integrity of the financial market, namely the protection of investors together with retaining its maximum functionality and efficiency.

2.1 Classification of the regulation and supervision systems

The systems of regulation and supervision are partly based on legal standards approved by legislative

bodies according to a proposal of an authorized subject and brought to perfection in implementing provisions issued by the regulatory body and partly on the ways and forms of controlling activities (control, monitoring, supervision) carried out by supervision bodies, which can either make part of the regulator or be independent. Numerous classifications have been created for an easier orientation in individual systems according to specific items which constitute these systems. As an example I would like to give a classification used in the above mentioned publication.³

1. The subject of regulation – institutional or functional systems
2. The extent of regulation – universal (general, all-embracing, or so-called mega-systems) or specialized systems
3. The number of regulators of the financial sphere – systems with one or several regulators
4. The position of the regulator in the system of state institutions - centralized or decentralized systems, or a combination of both
5. The powers of the regulator – autonomous or subordinate systems
6. The democratic nature of the regulator functioning – systems of the state regulation and supervision or systems with the elements of self-regulation of the regulated organizations or their craft associations
7. The way the regulatory activity is financed – either systems fully financed by the means of the regulated organisations or the systems fully financed by the means of the
8. national budget, or systems financed in a combined way
9. The way the regulation and supervision are exercised by the regulator – systems which use more formal and bureaucratic approach to solve the problems of regulation and supervision, or systems which lay the primary emphasis on the content (factual) side of a problem.

The above mentioned characteristics, which are intentionally given here as contradictions, however, do not occur in their absolute form in practice. Every concrete system of regulation and supervision is mostly a combination of individual elements while the importance of some of them is predominant. It is necessary and very difficult at the same time, while creating this real “mixture”, to keep a proper rate of combination, and that of compatible elements only. Although a generally acceptable optimal model is in practice almost unreachable, there is a theoretical possibility to create it by a combination of compatible elements. As an example we might possibly mention an autonomous functional system containing the elements of self-regulation, financed by the means of regulated subjects, which is factual, transparent and

² V. Pavlát, A. Kubiček: *Regulation and Supervision of Capital Markets*, pp. 12 - 40

³ V. Pavlát, A. Kubiček: *The Regulation and Supervision of Capital Markets*, p. 13

flexible, and at the same time relatively inexpensive and efficient. And it is, of course, possible to formulate quite easily an idea of the opposite to the optimal system defined that way. The created classification is an essential basis for a practical comparison of real systems existing in individual national economies, as well as for the creation of models of their further possible development.

2.2. Current main types of regulation and supervision of the financial market

There are three main types of the regulation and supervision of financial markets in the contemporary world:

- a. a **mega-system**, in which the only one universal regulator of the whole financial sphere ensures the regulation and supervision of the whole financial administration realized in a given national economy. I am going to deal with this type in greater detail in the following part of my contribution because I consider it to be generally the most progressive;
- b. a system based on the existence of a **pair of regulators**, each of them being in charge of administration related to the regulation and supervision of the financial market;
- c. a system of regulation and supervision which is carried out by **one or more specialized regulators**.

In the patterns used until now, the main types of systems of regulation were divided in such a way that the prevailing trend of development leading to uniting separate systems of regulation and supervision of individual segments of the financial market into a sole, universal and all-embracing entity – a mega-system or, in other words, an **integrated homogenous system** was obvious. However, this point of view is not only a view expressing an intention of the author, it is in the first place the necessity to emphasize the objectivity of the relationship between the development trends of the regulation and supervision, and the elementary development trend of the current financial market as a complex, internally differentiated system which moreover –with growing internationalization and globalization – will in future undoubtedly head for even more complex forms and ways of integration of the regulation and supervision of financial markets.

2.3. Optimization of regulation and supervision of financial markets and its possible methods

In any period of the current as well as the future development of the financial market, the views on the level and range of regulation differ considerably. The only thing they have in common is that the regulation

"has never been optimal". According to the views you may encounter on the level of individual subjects of the financial market, it is usually too severe and costly, not efficient enough, even unnecessary, etc. Under certain conditions of the financial market situation, such assessment and the like can be agreed upon even by those subjects that under different conditions have different views resulting from their different interests. Such situation is usually called **overregulation**, although it is mostly a considerable simplification. Under different conditions that can be associated, in a simplified way, with another stage of the business cycle and its usual excesses aimed at maintaining the so far achieved profit rate, the same subjects can consider the regulation too low, toothless, rigid, unable to predict future development, etc. but again too expensive and not efficient enough. This state is usually called, in a very simplified way, **underregulation**. Besides those two extremes there is also a third state, in my opinion more frequent, in which the views on regulation and supervision differ according to the nature of the interests of individual groups of subjects operating on financial markets, in a simplified way represented by investors on the one hand and financial services providers on the other.

The above mentioned facts and a whole range of other opinions result, both in theory and practice, in a permanent effort to optimize the regulation. Generally, it can be stated that this effort is carried out mostly in two levels, first in understanding the substance of optimization and its defining and consequently in realization of the defined. In any case, the third level of this effort, the level of permanent improvement of the result achieved in the previous two levels, cannot be neglected.

As far as the understanding or definition of an optimum system of regulation and supervision of the financial market is concerned, this issue was mentioned, though very briefly, in subchapter 2.1, so now I am going to be more specific about the above mentioned and to show some possible ways how to achieve the required.

First, let us raise the question what is "required" of financial markets regulation and supervision. Because I neither can nor want to deal with all the pleiad of possible answers and their analysis and assessment now, I will help myself out of it by something more or less agreed upon by the majority of theorists and practitioners, by an example of the definition of the role and objectives of the Securities Commission in Article 2 Section 2 of the Act no.15/1998 of the Collection of Laws, as amended: "The role of the Commission is to strengthen investors' and issuers' confidence in the capital market. The objective of the Commission is to contribute to the protection of investors and the development of the capital market and to support education in this area." We may encounter similar definitions, some brief, others florid, not only in legislation but also in numerous

publications of various nature published almost anywhere in the world in the past, at present and, undoubtedly, in the future, too. At the International Conference on Regulation and Supervision, organized by VSFS in 2003, I defined the basic objective of the regulation and supervision as follows: "maintenance and further development of a fully functioning financial market, namely in all its particular forms and shapes, to enable it to fulfil its basic purpose . . ."⁴ At the same time, it is necessary to emphasize that besides these basic, general, irrefutable, strategic objectives it is always necessary to define also the objectives and tasks concerning the changes in the financial system which took place in the past or are showing in outline as probable trends of development. In a modern dynamically developing economy, regulation and supervision must not lag behind the dynamism of financial markets development bringing new problems all the time, whose positive solution - in favour of investors - the existing regulation and supervision should contribute to.

If we consider an optimum system of regulation and supervision, then these considerations must unambiguously result in the premise of its **maximum flexibility**, which would not only secure a fast reaction to current problems by means of repressive measures (negative regulation) but also anticipate potential negative situations and apply the complex of its preventive measures in advance (positive regulation). Unfortunately, most of the currently used systems of regulation and supervision meet the prerequisite of flexibility and combination of suppression and prevention only partially.

When solving the optimization of the system of regulation and supervision, it is impossible to avoid the problem of efficiency of the institutions running the system. The efficiency⁵ of the whole system cannot depend on an optimum combination of its compatible elements only. As far as the costs are concerned, changes in the system are mostly connected with relatively high, but more or less nonrecurring costs, whereas the operation of executive bodies of regulation and supervision claims permanent supply of financial means. From this point of view, it is very important to define a set of materialized quantitative as well as qualitative indicators of results achieved by these bodies and compare them with the costs incurred. The procession of such a set of indicators is unfortunately still nascent and any complex agreement does not seem impending. The elaboration of these issues will be the objective of our research team in the near future.

⁴ In: *Regulation and supervision of financial markets. Proceedings of International Conference, VSFS, Prague, June 24 – 25, 2003, p. 28*

⁵ D.Loader: *Regulation and Compliance in Operation, p.xi*

3. Basic trends of the future development of financial markets and system of their regulation and supervision

I have already mentioned some basic trends of the future development of financial markets, such as internationalisation, globalisation, integration, intellectualisation, etc. Now, I would like to deal with two concrete forms of applying those trends, and than also with the reflection of those changes in required and partly also accomplished modifications of the system of regulation and supervision.

3.1. Financial conglomerates

The establishment of conglomerates, i.e. simply said economic subjects formed by joining units of various fields in the only one large complex, has been a momentous manifestation of trends in the economy since the last century. This phenomenon is quite new in the financial sphere mostly because the possibilities of free movement among individual segments of the financial market, at national and international scale, were until recently relatively considerably restricted due to the elements built in the existing regulatory systems. We can mention, for example, the strict separation, in force until recently in many countries, of commercial banking from securities dealing, as well as the separation of insurance activities from other fields of financial dealing. The gradual development of conglomerates, even in the financial sphere, could have occurred only at the moment of weakening of the field principle of regulation, and more generally at the moment when, as an important part of objective trends gaining ground in the field of financial market regulation, the principles of deregulation and harmonization were recognised by political will and projected into the relevant legal norms. It is also important to mention, and I will deal with this issue in greater detail in the following chapter, that this step has not been until now and cannot be very penetrative, and it is just because not everything is clear and solved down to the last detail and we do not wish for any unpleasant surprise.

Financial conglomerates are usually defined as: 'a group of companies under common control whose exclusive or prevailing activities are based on services provision in at least two financial sectors (i.e. banking, securities, and insurance)⁶

There are not only financial conglomerates but also mixed conglomerates in the financial sphere which are mainly focused on trading or other industrial

⁶ *The supervision of financial conglomerates. A report by the Tripartite Group of Banks, Securities and Insurance Regulators, July 1995, p. 13*

activities, but at least one regulated financial unit functioning within the framework of their overall structure must be included.

These types are, on the basis of their historical development, more or less connected with the individual national economies and, on top of that, they are regulated by legal regulations which are far from being fully compatible mostly because this is a new and not quite known issue, and various political and professional groups perceive it differently and their worries are different too. That is why these financial conglomerates regulated it with different intensity and by means of different instruments.

3.2. Financial derivatives

By financial derivatives we mean, for example for the purpose of our law of capital market dealings:

- a) options and investment instruments stipulated by this law,
- b) financial forward contracts (namely futures, forwards and swaps) concerning investment instruments stipulated by this law,
- c) difference contracts and similar instruments for the transfer of interest rate or exchange rate risks,
- d) instruments enabling transfer of credit risks,
- e) other instruments which result in the right to financial compensation, and the value of which is derived primarily from the investment securities rate, index, interest rate, exchange rate or the commodity price⁷.

In addition to the above mentioned financial derivatives there exist a lot of others which our legislative has not accepted and our practice has not managed to term yet. They represent the most dynamically developing and at the same time, from the viewpoint of the possibility of their rational and effective regulation and supervision, also the most problematic objects of the financial market. In my opinion, it was just on derivatives markets that one of the most important regulation principles was breached, namely the ability to enter the market was offered only to such investment instruments which are by their nature transparent, clear and controllable and such is also their trading, including their content and aims.

The popularity of financial derivatives originates in the possibility to use them in two ways: on the one hand they successfully hedge securities dealings against possible risks and, on the other hand they are suitable for speculations. While the first way results in the risk reduction, which is an important factor of

investor protection, the second way is connected with substantial risk increase, i.e. threat to investors, which could, together with a considerable institutionalisation growth in this segment, have fatal consequences.

Taking into consideration what has been said and the fact that not only the volume of derivatives trading but also the volatility on capital markets have considerably increased, it is quite understandable that the regulators have paid, in the last few years, a great attention to the speculative use of derivatives. Their effort – to elaborate and further develop methods of regulation and supervision of the activities of financial market institutions which deal with derivatives – is hampered by their unfinished integration at national as well as international levels, while integration and globalisation of derivatives trading is already in a more advanced stage. Since the mid 90s of the last century, it has particularly been the Committee for Technological Issues of IOSCO⁸ which, in cooperation with the Basel Committee for Bank Supervision operating with the Bank for International Payments in Basel, has been dealing with the issue of regulation and supervision in the field of financial derivatives trading on financial markets.

3.3. Main issues concerning regulation and supervision over financial conglomerates and business with financial derivatives

As an attentive reader must know, a number of issues of regulation and supervision have been already mentioned above, in addition to that they are mutually connected or sometimes even identical.

The key problem of regulation and supervision over financial conglomerates is the fact that these subjects represent heterogeneous group of companies with different kinds of business in individual segments of financial system. Some of these activities are subject to regulation and supervision but some not according to in which countries the companies are located.

Supervision over financial conglomerates deals with relatively wide range of phenomena and processes - the most important is examining of capital adequacy i.e. finding out if the capital of given financial conglomerate is sufficient for covering his business risk, and then a number of other specific problems as e.g. risk resulting from financial relationships inside the conglomerate, danger of so-called infection, examining of transparency of legislation and management etc. Traditional feature of supervision over performance of individual structural components is a practice where each supervisory body monitors only one type of regulated companies without

⁷ Article 33 Section 3 of the Act no. 256/2004 of the Collection of Laws, dealing with business activities in capital markets

⁸ International Organisation of Securities Commissions

sufficiently developed contacts with other regulators. This practice is not suitable and sufficient for supervision over financial conglomerates because only individual parts of the whole are being monitored and analyzed. It is almost impossible to get an overall overview on business risks concerning financial conglomerates without mutual co-ordination of activities of individual specialized regulators.

Gradual integration of regulation and supervision on national and also supranational level is, in my opinion, one of the most crucial way which is important to be followed in order to minimize if not totally eliminate consequences of this issue.

If we talk about regulation and supervision in the area of financial derivatives the cardinal problem is to define and create proper information basis. One of the results of activities of international organizations that I have mentioned in preceding sub-section is recommendation to apply so-called minimal standard at supervision over firms doing business on supranational level, especially in such cases when the scope of transactions of regulated companies is significant. Elaborating these standards supposes initial compilation of list of items (information) that are considered to be essential for risk monitoring related to using of derivatives – loan risk, risk of liquidity, market risk connected with business of derivatives. Another step is compiling of these items into catalogue containing compact file of information being considered as a minimal standard.

The aim of supervisory bodies is to pursue a scope using of derivatives i.e. monitor volume of businesses being concluded by regulated companies and to identify trends of their use. This information must be sorted out according to individual types of derivatives i.e. for swaps, financial futures, forwards a options and simultaneously according to if it concerns stock exchange or out of stock exchange transactions i.e. to monitor the risks really connected with them. It is also important to follow if the regulated companies with shown derivatives get on doing business themselves and use them for securing their transactions. Qualitative information is information on organizational structure of regulated companies, on systems of their internal control, on their policy and practice related to measuring and managing of risks relevant to derivatives. Supervisory bodies can get this information from various reports being prepared by relevant departments of regulated companies for management of the company e.g. report on internal audit etc.

Without saying that doing business with derivatives is connected solely with financial conglomerates of supranational provenience, this connection cannot be ignored and objective requirement of integration of regulation and supervision over financial markets is being strengthened. Another significant relevant aspect is using of derivatives by subjects from all

segments of financial market, wide scale of markets where transactions with them are being made and also technological integration of complex implementation of these deals beginning from supply and finished with their settlement. In my opinion, everything calls for gradual, thoughtful, multilaterally secured but urgent initiation of integration- first of all where it has not been instituted and where the reached level even requires it.⁹

4. Integration of regulation and supervision over financial markets and its Czech distinctiveness

I have already mentioned two of three basic trends specifying development of financial market –i.e. deregulation and harmonization. I dare say some notes on this issue. Supporters of liberal conceptions that mind any regulations are quite benevolent about regulation of financial market but if they hear about integration they are usually very critical. I would like to assure them of the fact that for most theorists and practitioners of regulation of the financial market tendency for deregulation is fundamental and that integration can be understood as removing of overlap and useless requiring of unimportant information, bureaucracy and petrification of unneeded and obsolete matters but also as objectively essential step enabling deeper knowledge of substance of regulated, faster reaction to new subjects, objects, processes and relations and problems connected with this origin, higher level of accepted solutions, larger share of positive regulation and increasing its effectiveness.

As for the trend of harmonization, it is, in my opinion, the crucial one for understanding of objectiveness of integration of regulation and supervision as a form of its harmonization with objective developing trends of financial markets having been mentioned above. Integration, internationalization and globalization of financial markets require the same level of regulation and supervision. The most important things is that this simple relation -that is not simple from the perspective of its practical implementation, must be understood by relevant state authorities and first of all politicians and enable its realization.

4.1. Existing procedures of integration used in selected countries

The contents of this paper cannot serve as an entire description of all existing procedures and changes in organization of regulation and supervision in

⁹ D.M. Abdelhamid: *International Regulatory Rivalry in Open Economies*, pp.22-43

individual national economies nor detailed specification of one of those. It would be beyond capabilities of this conference as well. Therefore I refer my readers to relevant parts of publication¹⁰ having been issued before and drive our attention to several of given countries.

At present, working classical mega-regulators are to be found in Great Britain, Germany, and Austria. Institutions like FSA, BAFin and FMA are well-known to specialists.

In Great Britain where the process of integration was finished as of December 1st, 2001 there was a change in responsibilities of Bank of England that saved its responsibility in the area of stability of financial system but responsibility concerning supervision over financial market has been transferred to FSA. Co-ordination of activity among the central bank, FSA and ministry of finance has been agreed on the basis of accepted memorandum. All the three institutions meet regularly on Permanent Committee discussing all system problems.

In Germany, an increasing significance of integrated financial strategies and financial conglomerates was clearly defined reason for origin of BAFin. A reform of German system of regulation and supervision was supported by novella of the main legal norms related to financial sphere: Act on Banks, Act on Supervision over Insurance Companies, Act on Security Transactions and Act on Stock Exchange of Securities. As for the relation between BAFin and Bundesbank in Germany exists so-called dual system. According to this system Bundesbank participates in bank supervision in co-operation with Bundesinstitution for supervision over financial services. "By comparison with some ideas existing in CR, the Bundesbank does not perform key function of banking supervision it is done by BAFin because only it is authorized by executive functions."¹¹

In Austria there has been the sole regulator – FMA since April 2002. Austrian federal ministry of finance transferred all responsibilities in the area of banking supervision, supervision over security market, insurance companies and pension funds. Responsibilities and rights of this institution have been stated in Act on Supervision over Financial Market.

¹⁰ V. Pavlát, A. Kubiček: *The Regulation and Supervision of Capital Markets*, str. 67 - 100

¹¹ Peter Baier: *Šance a rizika při vytváření integrovaného finančního dozoru v ČR, Pojistný obzor 9/2004, příloha*

4.2 Specifics of integrating the regulation and supervision of the financial market in CR

The first official and generally valid document, in which the intention of creating a certain level of an integrated relationship among individual organs of the regulation and supervision of the Czech financial market was simply formulated, was represented by the 15/1998C/L Law about The Commission for Securities and changes and completion of special laws, especially its Part 6 "The Cooperation with Other Institutions and Administrative Bodies", which defines in §§ 16 – 20 the basis and forms of mutual cooperation of KCP (Commission for Securities), ČNB (Czech National Bank) and MF ČR (Ministry of Finance CR) and is more specific about it in the relation of KCP to individual above mentioned partners and in addition to The Chamber of Auditors of The Czech Republic and to relevant administrative bodies and institutions of other states with the competence in the area of the capital market regulation. It is also necessary to mention a completion of the Law about The Czech National Bank with § 60a worded this way: "The Czech National Bank in cooperation with the Ministry of Finance and the Commission for Securities will create a system of mutual cooperation in the capital market area at the latest in three months since the operation of a special statute (1 April 1998, AK remark). No substantial changes were done in the mentioned provisions of the 15/1998C/L Law with the exception of § 20 – International cooperation, which was cancelled and with a substantially wider extent included into § 26 – The Duty of Discreetness and International Cooperation.

While preparing new laws compatible with EU Laws which came into force on 1 May 2004, the problems of integrating the regulation and supervision were already discussed but it was underlined in the government proposal of the law about the entrepreneurial activities on the capital market that: "The problems of double supervision will be solved only in the new conception of a consistent national supervision of the financial market."¹²

Then because of the above mentioned fact there was a surprising contribution of the deputy minister of finance of that period, Ing Jaroslav Šulc, CSc, at an international conference held by the College of Finance and Administration with the subject "The Regulation and Supervision of the Financial Markets" on 24 – 25th June 2003, where he gave to the surprise of other supervision bodies – ČNB (Czech National Bank), KCP (Commission for Securities), The Office for Supervision of Cooperative Savings Banks and other participants, too an integral proposal of the

¹² *The government proposal of the law about the entrepreneurial activities on the capital market*, pg 122, www.sec.cz

integrating of the regulation and supervision of the financial market in CR with enough arguments, though not fully detailed.¹³ A contribution of doc. Ing Jan Frait, CSc, the senior director and a member of bankers' board ČNB was not so surprising. The contribution was called "The bank supervision and the stability of financial system" and was presented at the conference held by VŠB-TU (Mining University) Ostrava 3 September 2003 with the subject "The Financial Management of Firms and Financial Institutions", from which I would like to give at least a quotation that in my opinion is possible to be taken as a perfect prediction of contemporary stage in this area: "Countries which decided to create an integrated supervision institution as a more or less autonomous part of the central bank chose this way a solution which uses natural preferences of the central bank it smartly eliminates potential conflicts and risks at the same time."¹⁴ It is possible to characterize the end of the year 2003 from the point of view of the development of opinions in the problems in question by a quotation from the daily papers *Právo*: "The financial market in the Czech republic will be supervised from 2009 – 2010 only by one institution instead of current four ones. The supervision of cooperative savings banks and banks should be united in two years, the control of insurance companies and pension funds will be amalgamated with the supervision of the capital market at first, in 2006. The two risen institutions should be united at least before the acceptance of euro."¹⁵

During the remaining part of the year 2003 and the beginning of 2004 the Ministry of Finance CR was taking care especially to the activities related to accepting, publishing and ensuring a without-problem operation of new laws related to regulating capital market, which came into force on 1 May 2004 – the Law of trading on the capital market, the Law of group investments, the Law of bonds and so called Law of changes, and at the same time the problems of the integration and supervision were taken more care.

The result of all negotiations, which took part in that time, was in my opinion a very serious decision which accepted the objectivity of the process of integrating the regulation and supervision of the financial market and at the same time it took into consideration the real stage of the development of this market in CR, too, it estimated correctly the possibilities and the time horizon of its future development at last but not at least the deepness and the extent of all existing risks and necessary preparing and realizing steps ensuring the implementation of this objective trend into the Czech

economic system without – of course while continuously monitoring, analyzing, evaluating and eventual correcting realized steps - redundant and its substance devaluating consequences. This determination was adopted by the Czech government valid decision on 12 May 2004 nr 452 and besides others individual phases of integrating and organizational steps related to their realization were determined here. In correspondence with the above mentioned decision the Ministry of Finance prepared a government law proposal, the aim of which was the realization of the first period of the integration – uniting the supervision of the capital market (KCP) and the supervision of insurance companies for pension additional insurance (MF) into the new originated Commission for the financial market and transferring the supervision of cooperative savings banks to ČNB. This proposal was adopted by the government in the decision nr 611 on 21 June 2005. First reading took place at 45th meeting of the Parliament and the proposal was commanded to be dealt with by the budget committee and by the permanent commission for banking, which has not been done yet.

On the basis of the above mentioned assessment, I must state that I was very surprised by the government resolution no.1079 from August 24, 2005 on the change in the intention to integrate the state supervision of financial market into a single institution¹⁶ and by the reasons for that change as mentioned in part III of the document ref.no.1338/05 that was prepared by the Ministry of Finance and served as a basis for government proceedings.¹⁷

The essence of the proposed change is a significant shortening of the integration process - it should be fully completed in 2008 - and with effect from April 1, 2006 all the supervision will become an organizational part of the Czech National Bank.

I can agree, though with some reservations, with the views of the Securities Commission in its press release from August 11, 2005 and especially in the following materials: "Institutional arrangement of supervision - key factors" and "Alternatives to integrated supervision arrangement in the CR"¹⁸, prepared by the Securities Commission.

Now let me mention a few of my own comments and doubts about the proposed change, which, I hope, the Parliament won't pass. I have formulated them as questions for the authors of the material for government proceedings.

¹³ *The regulation and supervision of financial markets, The international conference file, pg 40-46*

¹⁴ www.cnb.cz

¹⁵ *Právo, 25/11 2003*

¹⁶ www.vlada.cz

¹⁷ www.mfcr.cz

¹⁸ www.sec.cz

"Are you sure that:

- the current level of development of the Czech financial market really requires acceleration of the integration process of its regulation and supervision?
- it is really the best solution to transfer all the secondary regulation and all the supervision to an institution whose main mission lies somewhere else and where regulation and supervision will always be on the second place at the best, although a similar solution has already proved inappropriate?
- this transfer is sufficiently justified by the current importance of banking institutions on the Czech financial market or even by the possibility of higher level salaries in the Czech National Bank?
- passing the legislation enabling the integration represents a sufficient legislative basis for such a performance of regulation and supervision that would enable an efficient fulfillment of the objective mission, targets and tasks and also the development of regulation and supervision?
- it is correct to speak exclusively about the integration of supervision if supervision is mainly "an operational and feedback institute" for primary and secondary regulation and the material mentions only primary and secondary legislation, maybe for fear of the requirement to include primary regulation in the integrated system?
- it would not be really better to establish a relatively new and independent institution of secondary regulation and supervision, on the right foundations and at the right time, entitled with all the necessary rights and obligations which would enable it to fulfill the tasks concerning its mission and target?

Understandably, there would be a lot more other questions, comments and topics, but let's wait for the answers to the questions raised so far before we decide to formulate others. In that way the other questions will be of higher quality.

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