



British Bankers' Association
Pinnars Hall,
105-108 Old Broad Street
London, EC2N 1EX
Telephone: 44 (0) 20 7216 8800
Facsimile: 44 (0) 20 7216 8811
website: www.bba.org.uk

LIBA

LONDON INVESTMENT BANKING
ASSOCIATION
6 Frederick's Place
London, EC2R 8BT
Telephone: 44 (0)20 7796 3606
Facsimile: 44 (0)20 7796 4345
e-mail: liba@liba.org.uk
website: www.liba.org.uk

ISDA

International Swaps and Derivatives
Association, Inc
One New Change
London, EC4M 9QQ
Telephone: 44 (0) 20 7330 3550
Facsimile: 44 (0) 20 7330 3555
e-mail: isda@isda-eur.org
website: www.isda.org

**British Bankers Association (BBA)
London Investment Banking Association (LIBA)
International Swaps and Derivative Association (ISDA)**

Response to

CEBS CP09

Guidelines for Co-operation between Consolidating Supervisors and Host Supervisors

07 November 2005

BBA/ISDA/LIBA response to CEBS CP09

Introduction

BBA/ISDA/LIBA believe that CEBS Guidelines for co-operation between consolidating supervisors and host supervisors described in CP09 contain many useful statements about the need for open communication, co-operation and efficiency in the regulatory process and the avoidance of burdensome regulatory interaction with our members. We therefore welcome it and encourage CEBS and its members to move swiftly towards implementation.

In particular our members welcome the CP's focus on Article 129 of the draft Capital Requirements Directive (CRD) – which requires supervisors to work together to determine whether or not to grant a group permission to a firm to use an IRB or AMA approach for the calculation of their regulatory capital. Our members that are active across EU and other international boundaries only wish to submit one application for permission to use one of the advanced approaches.

As well as focussing on models approval within the EU we encourage CEBS to take the lead in promoting dialogue with third country regulators to ensure our firms', as well as regulators' resources are used effectively. Many of our members are already devoting considerable resources to the preparation of their advanced approach applications so the CP's attention to the model approval process is entirely appropriate, although we note that, in our view, some regulators are more advanced than others in their own preparations to receive advanced approach applications.

CP10 has re-opened the debate on a number of areas where individual regulators have already come to a conclusion. It would be useful for CEBS and national regulators to confirm that our members who are already well advanced with their application packs will not be expected to re-submit them based on later CEBS work and to ensure that the home and host state regulators of a particular firm are in agreement with this 'no-resubmission' approach.

We hope that the release of this CP will catalyse more supervisory attention to this important issue where necessary.

Our members' aspiration

Our members - banks and investment firms alike - operate in the global market and aspire to a more harmonised and convergent regulatory architecture throughout the world. We are encouraging regulators to cooperate together in the supervision of internationally active groups regardless of whether or not there is a legal framework requiring them to do so. We believe that this will lead to a more efficient use of supervisory resources and lower regulatory costs (which are ultimately borne by customers) for our members.

We are encouraged by CEBS's efforts to promote such an approach within Europe and support its commitment to this as evidenced by the significant number of

recently released CPs (!). All of these signal to us that the industry's and supervisors' goals are convergent.

In particular our members believe strongly in the consolidating supervisor model and its eventual application to Pillar 2 as set out in our response to CP03 revised. In our view the application of Pillar 2 to an individual legal entity of a group that manages risk centrally will not deliver a holistic view to the supervisor of a group's risk management practices. We understand that it is not within CEBS's gift to deliver a consolidated approach to supervision but believe the important work that it is doing should underpin a growing sense of trust between regulators from different jurisdictions. As this level of trust is enhanced through increased contact on issues such as model approval, we hope that legislators will consequently feel able to deliver a legislative environment in which supervision is predominantly performed at a group level, as foreshadowed in the model review clauses of the CRD.

The European Financial market

Q1 - Are there any changes not mentioned here impacting on the EU financial sector and in particular on the supervision of cross border banking groups?

Promoting greater global supervisory harmonisation

EU Supervisors recognise, like our members, that the EU is a sub-set, albeit a large one, of the global financial market and that they alone cannot deliver the global consolidated supervision of a banking group active across borders to which our members aspire. However, EU supervisors working through CEBS have an important role in leading the way towards a converged international regulatory approach and we encourage CEBS to take the lead in promoting better supervisory understanding and convergence in the Accord Implementation Group.

Just because CEBS and EU legislators cannot deliver global consolidated supervision now does not mean that the effort to promote such an approach is not worth making. In our members' views it definitely is and CEBS should not be shy of setting and pushing forward the AIG agenda and taking a global leadership role. It is as far advanced as any other regulatory body in examining the home/host issues which are so important to our members, and is thus well qualified to do so.

Those of our members that have been subject to supervisory colleges have been pleased by the degree of mutual understanding that they have generated. We encourage supervisors to continue with the supervisory college model and consider undertaking desk based, role-playing and scenario analysis to examine how they would together cope with the impending failure of a large bank under stress. Such an exercise would examine the differences in, for instance, deposit protection or guarantee schemes, individual regulator's intuitive responses and the legal process around winding up a bank. Having identified the differences that may impede the swift and equitable resolution of the near failure of an international bank, practices can be improved, principles established and protocols and bilateral or multi lateral agreements between supervisors revised. This should enhance the mutual trust between regulators that is an important pre-requisite to consolidated supervision.

Outsourcing

One area in which EU regulators may have to reach out to regulators in non-EU jurisdictions relates to outsourcing. Outsourcing, both to internal and external specialist functions, allows enhanced expert focus to be applied to some areas of the management of a banking group, permitting more appropriate resource allocation and ultimately more efficient capital markets.

Our members recognise that they cannot outsource the ultimate responsibility for their activities but do hope EU and non-EU regulators will work together to apply an accommodative approach to outsourcing. Outsourcing delivers real benefits that should not be eroded by over-intrusion by different supervisors into the way in which a group allocates risk mitigation activities.

QII What are your views of the need for a comprehensive and flexible framework between supervisors?

The modus operandi developed for co-operation between supervisors should certainly be flexible and comprehensive.

Flexibility

Basel principles generally sit over and inform regulatory practice, whether within the EU or elsewhere, but these principles are properly open to interpretation by national regulators as they are implemented within a particular jurisdiction. Regulators should not be too wedded to their own interpretation but recognise that different reflections of the same regulatory principles can be equally valid.

Comprehensiveness

The framework should be comprehensive but regulators should beware of bringing forward a very detailed and potentially over-engineered solution at the expense of the flexibility to which we accord greater priority. Each firm and each regulatory dialogue is likely to be different and the difficulties of accommodating every possibility could result in attempts to shoe-horn a particular situation into what is likely to be a cumbersome structure. We believe that in most circumstances mutual trust developed through regulatory colleges, will deliver a better, flexible outcome. However in the event of a very severe stress to a bank that is active across borders a formalised architecture for supervisory cooperation is needed. It is here we believe regulators should focus their attention.

Supervisory considerations with regard to these changes

QIII What are your views of the description of the respective interests and roles of consolidating and local supervisors within the proposed framework?

Our preference is for the consolidating supervisor to take greater responsibility for the supervision of EU subsidiaries of a group. But we recognise the host country's valid desire to be involved in the oversight of systemically important subsidiaries, as well as the legal responsibilities such a host country has for ensuring the stability of its own financial system.

A potentially difficult part of managing the home host mix is the need to challenge a host state supervisor's view of the systemic importance of a firm's local subsidiary where that view is at variance with either the group or the home state supervisor. Without robust challenge, existing duplicative procedures may be perpetuated. The supervisory college may be the appropriate forum for this challenge.

CEBS efforts to bring clarity to the current mix of responsibilities and procedures is applauded by our members but they recognise that without a clear political decision to grant the consolidating supervisor greater powers much reliance will have to be placed on creating a culture of mutual trust. CEBS has made significant strides to promote the cultural changes necessary and for their part our member firms see themselves as partners in this process.

QIV What are your views on the concept that supervisory cooperation should go beyond the mere exchange of information in order to enhance effectiveness?

We wholeheartedly support the view that cooperation between regulators should be much more wide ranging than mere information exchange.

In order to maximise the use of scarce regulatory resources tasks should be allocated to the regulator most able to undertake a particular role. This will lead to the more efficient interaction with regulators for our members too, reducing the costs of regulation that are ultimately paid for by the consumer. We believe this clear allocation of tasks between regulators is key to effective home/host cooperation with the objective of eradicating duplication.

It is important that the agreed framework for the division of work is transparent to all parties, including the regulated firm, and agreed by all participants. For the larger firms that are active across EU borders we envisage that the supervisory college could be a useful forum for this affirmation.

QV What are your views on the suggestion that supervisors should, with a view on efficiency, consider the possibility of performing tasks on behalf of one another in strict respect of each other's legal power and responsibilities?

We strongly support this suggestion and are pleased that the approval of advanced models under Article 129 of the Capital Requirements Directive, which is a technically complex area, is to be managed by the competent authority responsible for exercising consolidated supervision of the parent credit institution, with input from

relevant host state regulators. This mirrors the way in which risk management and model development tends to be focussed with a group centre of excellence, providing risk management services to subsidiaries and ensuring that they are measuring and managing risks in an integrated, homogeneous way. It will only be possible for the lead supervisor to assess the extent to which this group function effectively supports individual legal entities by providing the integrated risk management approach if it is possible to assemble information from all parts of the group, with the assistance of relevant host state regulators. This is especially the case in relation to the Pillar 2 assessment.

QVI Do you see major risks for the duplication of tasks under the proposed framework? If yes, which are these?

We see no obvious areas of overlap that could lead to duplication of tasks but do fear the possibility of duplication arising in regulatory reporting. In particular we ask CEBS to consider very carefully how reporting requirements can be coordinated for banks and investment firms and their subsidiaries which operate across borders. Our objective is that the common reporting framework should focus just on the components that supervisors need to inform them of a bank's capital requirements. These should be based on:

- The provision of key management information on regulatory capital requirements sufficient to highlight major trends;
- Reporting of core regulatory capital data only;
- Regular reporting to complement other supervisory tools;
- An evolutionary approach.

Whilst none of the proposals in CP09 would obviously lead to duplication of tasks we are taking this opportunity to emphasise our view that reporting should be proportionate and relate to core parameters and be to the consolidating supervisor only.

We see the home state consolidating supervisor as being the channel between the firm and host state regulators and expect that there will be only very minimal direct contact between a host state and, in particular the branch of a firm lead managed in another member state.

QVII Do you wish to make any comments or suggestions with regard to the considerations set out in this chapter?

Whilst we acknowledge that the Pillar 2 Supervisory Review and Evaluation Process can apply at the level of the individual institution, at a sub consolidated level or at the level of the overall group it is our aspiration that the good dialogue that is foreshadowed in this Consultation Paper will reduce significantly the number of occasions on which Pillar 2 processes are applied at sub-consolidated or individual levels. Applying Pillar 2 at anything but the highest level will impose additional burdens on our members and result in only a partial understanding of the group and

its risk profile ignoring, for instance, diversification effects or introduce complexity where national discretions have been implemented differently.

We would wish to see more material from CEBS on its relationship with non EU regulators. The EU single market in Financial Services will be strengthened if EU firms are able to expand their businesses globally and if third country firms are able to compete in the EU on a level playing field. Whilst CEBS's CP on home host cooperation provides an excellent framework for regulatory relationships within the EU it does not touch on relationships with third countries.

It is clear that the work of CEBS is highly influential and of interest to regulators outside the EU. We welcome this as it will assist gradual international convergence. But we encourage EU regulators to reach out actively to their peer group. CEBS should take the initiative and use all pragmatic opportunities to coordinate and cooperate with third country regulators when implementing the CRD and Pillar 2 in particular. Otherwise a critical dimension of information concerning internationally active cross border groups could be missed. Our members would welcome a strong statement from CEBS that third country regulators – who may be the regulators of the parent entity, or of significant sub-groups – will be incorporated fully into the regulatory assessment of the group as a whole.

Overview of the EU framework

QVIII What are your views on the significance of each entity within a group And/or within its domestic market as key elements, with a view on proportionality, for structuring the process?

As we have highlighted above it is not clear to us is how home and host regulators' differing perceptions of whether a particular subsidiary or branch is significant will be resolved. Our preference, of course is that the final determination will be made by the home state regulator but whatever the outcome, it is important that the firm itself is be aware of and involved in the discussion about significance at an early stage.

Q IX What are your views on the proposed approach to assess significance? Do you want to make any suggestions to improve this approach?

The factors identified in the CP to determine significance are appropriate. However a firm's business within a particular country will ebb and flow, so there should be a periodic review of the significance assessment to ensure it continues to be appropriate.

Guidelines overarching the practical co-operative framework

QX What are your views on the general description of the process as set out in the tables above? Does it depict a logical, workable and comprehensive approach?

On the whole our members do not like check lists as they inevitably lead to a tick box approach to supervision. Whilst it appears the tables are to be structured as a check list they do seem to set out all the relevant factors required to stimulate the free flow of essential information between home and host supervisors and to enable them to plan and coordinate their activities effectively.

We would be nervous if the lists were directly translated in to a 'form' that firms were required to complete on behalf of the regulator. The amount of essential information to be exchanged and the planning and coordination of supervisory work should be arrived at as a result of dialogue between the firm and the regulators that are most involved in regulating it, not as a result of the exchange of completed forms.

Our objective is to ensure that all significant requests for information about the way in which risk is managed at a group level are routed via the home state regulator and that the host state regulator should only ask for information directly from a firm's branch or subsidiary when it has been pre-identified as being systemically important for the host state concerned. In such cases the home state regulator should be notified and any information collected shared with it, so that both home and host regulators are aware of all information requests and planned meetings.

We are not sure that this concept is as enshrined in the text of CP09 as we would hope. For instance on the bottom of page 15 reference is made to the '(sub) consolidating supervisor'. We assume that this refers to circumstances where a third country group is managed in the EU by a regulator responsible for its EU parent holding company pursuant to the Financial Groups Directive.

QXI Do you see additional potential for stream lining the process of co-operation, under the present legal provisions? What suggestions do you wish to make in this respect?

The long term aim of our members is to move towards a consolidating supervisor model where the home state supervisor acts as a single point of contact on prudential issues, co-ordinates and collects appropriate input from host state supervisors of systemically important branches and subsidiaries, is responsible for model approvals, makes decisions about group wide Pillar 2 issues and approves capital and liquidity allocation around the group.

Where appropriate, cooperation should involve all relevant supervisors and not be based on many bilateral relationships. We see the supervisory college as the right forum for ensuring that cooperation is as streamlined as possible.

CP09 is a good step in the right direction to achieving this. As we have highlighted above we are concerned about the regulatory reporting requirements that will be imposed on our members and are aware that different EU regulators are likely to have different requirements in relation to the granularity of information they require. We are comforted that CEBS seems to have cut down on the amount of information required by the draft Integrated Regulatory Reporting templates and also but would welcome a statement that no host state regulator will request more information of a

local branch or subsidiary than the parent company is required to provide its home state supervisor.

Practical framework (group and branches)

QXII What are your views on the general description of the process as set out in the tables above? Does it depict a logical, workable and comprehensive approach?

In our ideal world there would be very little additional interaction by a branch in a host state with the local regulator but we recognise that this is not likely in the short term. For now the description set out in the tables appears appropriate but would expect this process to wither over time.

QXIII Do you see additional potential for stream lining the process of co-operation, under the present legal provisions? What suggestions do you wish to make in this respect?

We hope that in due course the degree of interaction with the host state regulator by the local branch of a banking group across EU borders will be very low indeed. We believe this situation will be achieved as regulators become more conversant with each others regulatory techniques as a result of their participation in regulatory colleges. We encourage all regulators to join in the regulatory college process with enthusiasm.

Practical framework (model approval)

XIV Do you see any serious obstacles to the smooth process of model approval stemming from the proposed tasks executed by the consolidating supervisor and host supervisors? If yes, what are they and how can they be removed?

Our members are very supportive of the model approval process envisaged by Article 129, which recognises the reality of how they develop and approve models themselves. Models are generally developed at a group risk level and then modified where necessary to accommodate local specificities, subject to group risk oversight and approval. We hope that home and host state regulators will cooperate in a similar way to ensure that the application and approval process is streamlined and in reality really is focussed on the home state regulator.

Pre-application

Our members may wish to have a range of discussions with different regulators about their plans to use internal models. Whilst we recognise that ‘compulsory’ notification of such discussions to other regulators – including most importantly the consolidating supervisor - cannot be mandated by CEBS, we do hope that there will be a cultural expectation that the outcomes of any such pre-application discussions

will be communicated voluntarily. This transparency will help inform those regulators involved in a firm's single models approval application and lead to better planning of the process at an early stage.

Formal Application

We support the emphasis on the role of the home state supervisor but recognise that the host state regulator will wish to comment on aspects of it that are relevant to the group's business in its own jurisdiction. The scope of the host state's involvement should have been prescribed at the pre approval and planning stage - mission creep should be resisted! The agreement of timings for the response, where necessary, from the host state regulator should be pre-agreed to ensure this does not happen.

Model Assessment

This section appears to contemplate multiple application packs for model approval. Our preference of course is for one approval pack only to be submitted to the home state regulator which will then distribute appropriate portions (but not all) of it to those host state regulators that have a local role to play.

Decision

We recognise that agreement from all involved regulators is preferable but think the term used in the host supervisor column in the table that would better reflect the host regulator's role would be 'concur', rather than 'agree' – to emphasise the different weightings that home and host regulators have in the process – and also the ultimate reality that if agreement cannot be reached, the home state regulator has the final right to approve models.

Implementation

We have no comments on this section.

On going review

As CEBS will be aware we believe that Pillar 2 review should be carried out by the home state regulator and applied at group level to ensure the regulator has a holistic view of its activities. Whilst the CRD requires Pillar 2 to be applied at a sub consolidated or institutional level we do hope this requirement will eventually be removed.