

Brussels, 18 January 2008

To: 3L3 Committees CESR, CEBS, and CEIOPS

Mr. Carlo Comporti
CESR - Secretary General

Mr. Andrea Enria
CEBS - Secretary General

Mr. Carlos Montalvo Rebuelta
CEIOPS - Secretary General

Subject: Response to 3L3 Work Programme consultation (CESR 07-775/CEBS 07 171/CEIOPS-3L3-11-07)

Dear Messrs, Comporti, Enria, and Montalvo Rebuelta,

The European Banking Federation (EBF)¹ welcomes the initiative of the three Level 3 Committees ("3L3") of publishing a common work programme for the period 2008-2010. The EBF has worked with the 3L3 over a number of years since their inception because the initiatives undertaken by the Committees have the potential to promote more effective and appropriate supervision in and for Europe, a common aim for Europe's supervisory and banking communities.

The initiatives proposed by the 3L3 assume an added importance at this time of continuing turmoil on the credit and financial markets. There is therefore an added incentive today for the 3L3 to build on the political backing for greater supervisory co-operation and convergence achieved towards the end of 2007 and develop pragmatic, business oriented, solutions to the challenges posed to the current supervisory arrangements in Europe.

The EBF believes that the priority of the 3L3 has to be on building trust and confidence between supervisors along the road to fostering a common supervisory culture for Europe. Increased reporting of the activities of 3L3 to the major European Institutions, where the respective Committees would be encouraged to report on progress and/or explain why progress had not been achieved will, we feel, be just one important facilitator of convergence.

Our detailed response is enclosed. We trust that you find in our response recommendations that would achieve mutually beneficial outcomes for supervisors and the industry alike. We feel strongly that the 3L3's high level of consultation with stakeholders over the years has proved beneficial to its work thus far. We are very keen to continue to work with supervisors and be part of the solution to the challenges currently facing pan-European supervision of firms.

For further queries please do not hesitate to contact me or my colleagues Stephen Fisher (s.fisher@ebf-fbe.eu / n.francheterre@ebf-fbe.eu).

Yours sincerely,



Guido Ravoet

Enclosure: 1

¹ The European Banking Federation (EBF) is the voice of the European banking sector representing the vast majority of investment business carried out in Europe. It represents the interests of over 5,000 European banks, large and small, from 31 national banking associations, with assets of more than €20,000 billion and over 2.3 million employees.

Response

3L3 Medium Term Work Programme

(CESR 07-775 / CEBS 07 171 / CEIOPS-3L3-11-07)

1. The European Banking Federation (EBF)¹ welcomes the initiative of the three Level 3 Committees ("3L3") of publishing a common work programme for the period 2008-2010. The EBF has worked with the 3L3 over a number of years since their inception because the initiatives undertaken by the Committees have the potential to promote more effective and appropriate supervision in and for Europe, a common aim for Europe's supervisory and banking communities.

General remarks

2. We commend the 3L3 for their positive contribution towards enhancing regulatory and supervisory consistency across the securities, banking and insurance sectors. **We also urge the 3L3 to capitalise on the not inconsiderable political will to make progress on improving supervisory co-operation within Europe.** We consider this objective to be of even greater importance as we write during a period of significant turmoil in the credit and financial markets.
3. We believe the issues identified to be generally aligned with the recommendations arising from the recent review of the Lamfalussy Process. Therefore, **we do not think that the work programme needs to be adapted in light of the Lamfalussy Review.**
4. The medium term Work Programme focuses on a number of important areas common to the three Committees. However, much of the proposed work is based on the assumption that supervisors have a long tradition of trust and reliance on each other, are equally knowledgeable and interpret regulatory requirements in a consistent way. Unfortunately, experience has shown that this is not always the case in practice. Therefore, **we believe that the 3L3 should focus on improving supervisory cooperation and convergence within the Committees as a necessary pre-condition to ensuring efficient cooperation and convergence across the three sectors.** At the same time, ongoing cooperation within the areas described in the 3L3 medium term work programme should be pursued to pave the way to a true cross-sectoral approach to financial supervision in the near future.
5. Taking into account the current legislative framework, **we would urge the 3L3 to concentrate on issuing pragmatic solutions over further recommendations,** as a

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more effective means to promoting the changes necessary for supervisory cooperation and convergence.

6. In general, **work towards further convergence across sectors over 2008-2010 would be strengthened by defining a clear mission statement common to the 3L3 for that period**, in which European cooperation, convergence and financial stability should be explicitly defined as the principle objectives of the 3L3. In particular, a commitment of the 3L3 to deliver tangible maximum consistency, especially in the prudential area, should be included.
7. In this common 3L3 mission statement, for 2008-2010 the 3L3 should furthermore subscribe to the following political goals:
 - to allow large financial institutions to act as one institution and operate across borders within a truly single European financial market without any intra-EU barriers;
 - to aim at a fully harmonised and consistent implementation of regulation throughout the EU, with no national option and discretions in the prudential area or room for gold plating in general, to thereby avoid divergent national interpretations and implementations;
 - to contribute to achieving a consistent approach to supervision on the basis of colleges of supervisors.
8. Furthermore, to promote consistency between the design of 3L3 measures and their application at national level, supervisory authorities' mission statements should also include **explicit reference to the objectives of European supervisory cooperation and convergence and financial stability**.
9. **The 3L3 should be made accountable to the EU institutions and report to them on the degree of supervisory convergence achieved**. Supervisory authorities which have developed guidance that diverges significantly from the common approaches developed at Level 3, thereby potentially jeopardising convergence, should be required to explain why such divergence was deemed necessary.
10. Supervisory commitment for further convergence should be underpinned by **enhanced transparency towards the market on the convergence process through a more frequent publication of progress reports**, for example on a biannual basis, and through a more widespread use of supervisory disclosures e.g. Article 144 of the Capital Requirements Directive (CRD).

Detailed remarks

11. For the sake of consistency we follow the structure of the consultative document in our response. We set out below detailed positions and comments on the various elements of the Work Programme.

A. Common 3L3 framework for co-operation between national authorities

12. Firstly, we strongly agree with the 3L3 that work on **home-host cooperation will be of primary importance going forward** (Paragraph 15). This issue currently assumes a renewed importance since if the cooperation is effective then it is a useful framework to understand and mitigate against the potentially damaging impact of the ongoing turmoil in the credit and financial markets.
13. At the **global level there also needs to be closer regulatory dialogue and cooperation between regulators and the industry to develop convergence of approaches and better understand the issues**. Interaction with other regulators should include, but not be restricted to, dialogue with regulators from other major financial services centres (e.g. USA, Canada, Switzerland, Japan, Australia, China), work in the Financial Stability Forum and in international sectoral organisations such as the Basel Committee on Banking Supervision, IOSCO and IAIS.
14. The EBF considers that **supervisory colleges have a crucial role to play by allowing for intensive dialogue, cooperation and coordination between the supervisors involved** (Paragraph 16). Common standards for the operation of colleges need to be defined including allocation of roles and responsibilities to each supervisor involved, decision-making procedures, exchange of information arrangements and delegation of tasks to ensure convergent supervision of cross-border banking groups. It is essential that supervisory authorities nominate delegates with appropriate powers to sit in colleges to ensure they are in a position to commit to particular tasks and decisions.
15. However we query what is intended by the 3L3's proposal to "**submit own-initiative recommendations to higher levels whenever inconsistencies arise in Level 1 or Level 2 legislation [...]**" (Paragraph 17). The CESR protocol on the supervision of branches under the Markets in Financial Instruments Directive (MiFID) could be one example where the Committee came with its own proposal to work through the practical difficulties arising from the legislative requirements set at Levels 1 and 2. Whilst we welcomed CESR's work in this area we remind the 3L3 that industry has an important role in coming to and delivering the solution and must therefore be continue to be consulted in any such own-initiative projects.
16. **Delegation of tasks and responsibilities are key features of the efficient organisation of the home-host relationship** (Paragraph 18). We therefore support the 3L3's intention to look into the obstacles to delegation with a view to present legal and practical means to overcome these obstacles. Delegation of tasks is possible under Article 131 of the CRD and will be brought into focus through the application of the CESR protocol on the supervision of branches under MiFID, but has never been used in practice partly due to issues of responsibility. A supervisor who has delegated a task still holds responsibility for the supervision of the institution concerned. Moreover, further work towards greater cross-jurisdiction

and cross-sector consistency in supervisory powers should also allow facilitating delegation of tasks and responsibilities (see paragraph 18 below).

17. Nevertheless, amongst the various issues listed by the Committees for examination (paragraph 18) is the issue of “differences in the availability of resources and payment for local supervision”. **We do not consider that differences in budgetary resources ought to constitute a true barrier to supervisors performing a delegated task and/or responsibility.** Rather, supervisors are encouraged to make the best uses of the resources available to them in the short to medium term whilst discussions continue about the financial support the 3L3 could receive in the medium term. Furthermore, we suggest that supervisors should capitalise on the political will to improve supervisory co-operation² by finding practical workarounds to possible impediments to greater cooperation introduced through legislation at Levels 1 or 2.
18. We agree with the 3L3’s proposals to enhance information sharing across (Section A.2(i)) sectors and borders both on an ongoing basis and in times of stress. The overriding objective of information exchange arrangements should be to **eliminate duplicative information requests to a financial group and to foster trust and cooperation between the supervisors.** There should therefore be a single contact point for all information requests pertaining to a cross-border group.
19. We furthermore support joint access to sector databases for supervisors. It should be possible for internal IT systems to be compatible and transfer data from one supervisory authority to another so that **all authorities involved in the supervision of a group have equal access to the financial information that is relevant to them and information requests are streamlined.**
20. We strongly support the continuation of the 3L3 IT work on databases to enhancing the reporting framework applicable to financial institutions. **Common formats for financial institutions reporting to supervisors are essential,** not only per sector, but also across sector for those which are under supervision within more than one sector.
21. When improving the common reporting framework, the experiences gained from designing and implementing FINREP and COREP should be kept in mind:
 - first, EU level reporting formats should not consist of collating all existing practices but rather of identifying and then applying the best practices;
 - second, the reporting content and supporting IT-framework are highly interlinked. The reporting content, validation rules and XBRL-taxonomy must be aligned as a change in one of the latter would inevitably affect the others.

² As per the ECOFIN conclusions on the 2007 Lamfalussy Review of 4 December 2007 and the report on financial services policy (2005-2010) – White Paper of the European Parliament as adopted on 28 June 2007.

This would create inefficiency and administrative burden for institutions and regulators alike;

- third, it is essential that a dialogue amongst supervisors be fostered on a regular basis to avoid a different interpretation by supervisors of the same content; and
- fourth, the 3L3 Committees should consider the interoperability and/or mutual recognition of the different reporting requirements by supervisors to reduce the overall reporting burden. If certain information is required in one reporting format, it should not be necessary to request it elsewhere.

22. We see merit in the 3L3's intention to conduct cross-sector analysis by 2010 on supervisory powers and enforcement sanctioning to address differences amongst supervisory authorities (Section A.2 (ii)). **We have long been calling for cross-sectoral consistency in supervisors' powers and this is an encouraging step in that direction.** This process should however be staggered. Firstly, supervisors should have sufficient powers to be fit for purpose in their particular jurisdictions. Then at a second stage attention should focus on ensuring consistency of powers and enforcement sanctioning whilst respecting the legal basis under which national supervisors operate. Moreover, supervisory powers should be designed to enable an appropriate and proportionate approach to resolving issues and addressing risks and to facilitate the delegation of tasks and responsibilities for cross-border banking groups.

23. We believe that the 3L3 initiative to look at inspection practices (Section A.2 (iii)) with a view to increase cross-sectoral convergence will prove to be constructive and should contribute to fostering a common supervisory culture. We furthermore support the proposal to further develop IT tools to support exchange of information on inspection practices. However, considering the divergences in funding supervision across Member States (market participants or governments), we do not consider that this exercise should be "subject to available funding" (paragraph 29). Going forward, **further work on databases is essential not only to facilitate convergence of practices but also to enable swift information exchange and therefore ought not to be impaired by budgetary constraints.** A comparison should furthermore be made of the costs of supervision across Member States per contributing entity.

B. Developing 3L3 convergence of regulatory and supervisory practices in key areas

Competing products (Section B. (i))

24. **We do not believe that a case has been made so far to classify the issue of products assumed to be competing as a priority.** Indeed, it is our impression that the current attention that is being given to this subject ignores the extent of the changes that MiFID will bring. In particular concerns such as the mis-selling of products or a potential preference from the distributor for one product over another due to monetary incentives are inappropriate in our view at a stage when MiFID

only came into force very recently and is not even implemented in some Member States.

25. This does not imply that we dismiss the considerations outlined by the 3L3 Committees. Indeed, we agree in principle with the objective of due consumer protection under all retail investment products. **However, a fair assessment of the need for further work on this issue can only be made after MiFID has been fully implemented and applied to distribution practices on a consistent basis.** Moreover, a call for evidence as currently carried out by the European Commission is the right approach to scrutinise in the first place to what extent there is a problem at all. We are surprised that the 3L3 Committees agreed that this should be a priority, even before the results of the Call for Evidence are available. We would therefore suggest that the 3L3 **put this project on hold for the time being and reconsider it together with the European Commission on the basis of a clearer understanding of the impact of the MiFID on distribution practices.**

Credit rating agencies (Section B. (ii))

26. Credit Rating Agencies (CRAs) have certainly had a role to play in the unfolding story of the ongoing financial turmoil and we agree that several aspects of their conduct will have to be carefully scrutinised. We underline however that the **shortcomings that have become apparent are restricted to the ratings of structured instruments.** It is therefore clear in our view that there is no need to re-open the debate about CRAs in the round. Rather, we continue to support the IOSCO's Code of Conduct in general, encourage CESR in its work to ensure that the Code is duly implemented on a "comply-or-explain" basis and developed further in light of industry experience.
27. As regards the specific aspect of ratings of structured instruments, a thorough and evidenced-approach will have to be pursued to avoid any over-reaction. We also expect that it will be possible to **solve the issues that will become apparent in that debate within the IOSCO Code of Conduct. Importantly, we reiterate that the regulation of credit rating agencies would likely be of major harm to the industry** not only in light of the conception of this business, but also in view of the oligopoly situation that regulatory prescription would most likely aggravate further.

Anti-money laundering and counter terrorism financing (Section B. (iii))

28. We support the 3L3 practical work programme in this area. **We encourage supervisors to engage with industry when preparing "a catalogue of common pragmatic responses to specific issues identified".** It is important that supervisors understand what issues industry is confronted with in the daily application of the Third Anti Money Laundering Directive and what industry undertakes to address them.

Commodity derivatives (Section B. (iv))

29. We note CESR's and CEBS' continued work on the Commission mandate.

Cross-border consolidation (Section B. (v))

30. We welcome the 3L3's follow-up from the adoption of the Cross-border Consolidation Directive. Indeed, as we had indicated during the adoption process, **the information to be submitted to the supervisors and a common interpretation of the assessment criteria should be defined by the 3L3.** A cooperation framework should moreover be agreed upon by the supervisors to ensure their assessment is conducted within the set deadlines. We nevertheless recall that it is important that market participants be fully involved in this work.

Internal governance (Section B. (vi))

31. The way a financial institution structures its internal governance impacts on its day-to-day business and services to its customers. Cross-sectoral guidance should therefore respect the fundamental responsibilities of both the supervisory and executive management functions within a given institution. **Guidance on internal governance should follow a principles-based approach and be of practical assistance to institutions** rather than imposing an additional layer of costs which would be beyond the scope of the CRD and MiFID.

32. Before giving any advice on how to harmonise MiFID and the CRD in this area, **a study should be launched to examine what differences there are between both texts and what issues are subsequently generated.** However, given that MiFID and the CRD have just been implemented, we suggest that further experience of operating under both regimes should be gathered before launching such a study. Our recommendation is therefore to begin a study after 2008.

Financial Conglomerates (Section B (vii))

33. We welcome the work carried out so far by the Interim Working Committee on Financial Conglomerates (IWCFC) and encourage it to further its work in close cooperation with CEBS and CEIOPS to **ensure consistency with the CRD and Solvency II in the definition of own funds.**

34. We furthermore welcome that the IWCFC will be a key interlocutor in other work streams of the 3L3 in the medium term such as cross-border consolidation, home-host cooperation, internal governance and capital modeling. Nevertheless it is important that the work of the IWCFC remains focused on those issues that are specific to financial conglomerates, taking care not to extend its scope to issues that may be more properly and effectively resolved via either the banking or insurance sectors.

35. It would be helpful to have greater clarity as to what the European Commission is aiming at in the review of the Financial Conglomerates Directive (FCD). In our view, the ultimate objective of any regulation on financial conglomerates should be to establish legal structures which are neutral and which do not create competitive distortions (particularly, but not solely, in the area of capital requirements) between:

- truly mixed groups and those which are dominated by a bank or an insurance company;
- bank-dominated and insurance-dominate groups; and
- conglomerates and stand-alone institutions.

Capital modeling CRD (Basel II) and Solvency II (Section B. (viii))

36. We agree that the implementation of both the CRD and Solvency II provide for an opportunity to create a level playing-field (see above paragraph 32) and convergence as well as enhance supervisory cooperation across sectors, but that it may also pose challenge to groups combining both activities and supervisors applying both regimes.

37. In that sense, we agree that work in this area is worth undertaking. However, we would welcome it if the 3L3 could **clarify on which aspects they intend to concentrate to address challenges**. For instance, it is not clear whether the intention would be to assess how institutions create their own capital models or how supervisors undertake comparative work on how to assess such models under Pillars I and II.

38. In any case, it is essential to **avoid imposing duplicative or conflicting requirements on financial conglomerates on the basis of the ‘same risk – same rule’ approach**. Financial conglomerates thus need to be allowed to adopt a group-wide perspective for their capital modeling.

Own funds definition – Definition of eligible capital requirements (Section B (ix))

39. The EBF has long argued that the **different nature of the business in which banks and insurance companies are involved should not have an impact on the definition of eligible capital**. In our view, the definition of eligible capital should rely on the same guiding principles across sectors to ensure a level playing field, including consideration of the purpose for which capital is held. Furthermore, a principles-based, outcome-focused, approach will enable the regulations to keep pace with and facilitate innovation. We insist that work at EU level on the definition does not precede work being undertaken at international level e.g. by the Basel Committee.

Valuation of financial instruments (Section B (x))

40. The **main issues arising from the current market turmoil** from the valuations perspective which require further investigation can be classified under three main headings:
- valuation of trading positions, particularly those positions that are mainly credit risk sensitive (this includes leveraged credit commitments and the sources of inputs to valuations);
 - valuation of illiquid trading instruments;
 - consolidation of off balance sheet vehicles such as SIVs, conduits and money market funds; and
 - disclosure of risks including the management of liquidity risk.
41. The financial turmoil has highlighted accounting valuation issues which require further investigation. The banking industry agrees that the fair value measurement provides an appropriate accounting base for financial instruments held for trading purposes or otherwise managed on a fair value basis. However, **full fair value measurement of financial instruments would overstate the extent to which instruments are held for trading or managed on a fair value basis within the business and the extent to which deep and liquid markets exist.** These are highly significant factors in determining the relevance of fair value in financial reporting.
42. **We support a model which would allow the fair value measurement of those assets and liabilities managed on a fair value basis** but at the same time recognise that not all financial instruments – let alone non-financial assets and liabilities – are managed on a fair value basis or are even capable of reliable fair value measurement.
43. It is essential that all the issues resulting from financial turmoil are worked through in a rigorous and disciplined manner in order to draw a complete and not misleading picture of the impact of the current and continuing market turmoil. Although some banks have published third quarter results under either US GAAP or IFRS, so far relatively few banks have disclosed the impact of the turmoil on their profits in footnotes to the financial statements. **The reality is that the banking system continues to work through the current market turmoil and the accounting issues that flow from it. It is clear that new challenges may arise in the weeks ahead as different market conditions are created.** Furthermore, the industry expects some detailed discussions with the audit firms in the preparation of their year-end financial statements and that, although these discussions are in many cases underway, they are not complete and must be given the opportunity to run their course as only then will a clear and full picture of all the issues emerge.

44. Generally, the European banking industry will adopt IFRS 7 in their 2007 audited accounts for the first time. These disclosures will not be available until March 2008 at the earliest and will depend on the date of publication of their accounts. These disclosures will be carefully reviewed by the market to understand properly the risks of each bank. In addition to IFRS 7, the industry will be making new disclosures under Pillar 3 of the Basel II Accord for the first time during the coming years. These disclosures are intended to fulfill the market's need for greater transparency by allowing market participants to assess key pieces of information about the risk exposures and the risk assessment processes of institutions. While it is important to allow the banking industry to implement these disclosures before considering wholesale change, we can see a case for reviewing the securitisation disclosures in light of current market conditions in order to assess whether they need augmenting, e.g. in terms of the level of detail.
45. We also expect a clearer picture to emerge during the year-end process of the critical accounting judgments and issues and the differences of accounting treatment between US GAAP and IFRS.
46. Only once all these events have unfolded will it be appropriate to determine whether further accounting guidance is required.
47. We would like to encourage CEBS to engage in the discussion with the banking industry, the IASB and other relevant accounting standard setting bodies with regard to the discussion on scope and application of fair value measurement for financial instruments. As the valuation standards for financial instruments including structured products, have implications for risk management practices of financial institutions, we would like to recommend CEBS to support the BCBS in considering what appropriate prudential filters need to be applied, ideally at a global level.

C. Common 3L3 tools and working procedures

48. We support the development of tools for the 3L3 to be in a better position to fulfill their role of fostering supervisory convergence. **Sector specific common training and staff exchanges as well as the development of a 3L3 training platform certainly are positive initiatives** in that respect (Paragraph 55). We believe that such training should put emphasis on levelling the playing field in terms of the degree of knowledge / sophistication of supervisors within each sector and across sectors so that a single interpretation to a particular regulatory requirement may be applied throughout the EU.
49. We believe that a cross-sector access to the mediation mechanisms could contribute to bringing the convergence process forward by helping to achieve truly converging practices across sectors (Paragraph 57). **Mediation should serve to provide cross-border and cross-sector financial institutions with solutions to the difficulties which they are experiencing within the framework of the current architecture:** multiple requests for information, imposition of potentially conflicting

requirements and differences in supervisory interpretation of financial services legislation provisions.

50. Taking into account the 3L3 current legal competences, **supervisors should commit to comply with the outcome of a mediation procedure.** Compliance should be assessed through a transparent peer review process (Paragraph 56), coupled with a comply-or-explain mechanism. This would allow assessing reasons for non-compliance and, where appropriate, put pressure on the supervisory authority concerned. The 3L3 should report these explanations to the European Institutions and they should be made public.
51. We welcome that the 3L3 have adopted an Impact Assessment methodology (Paragraph 58) which should be applied in future policy work (*ex ante*). **As we set out in our response to a related consultation** (“Joint Consultation on Impact Assessment Guidelines for EU Level 3 Committees”), **reviewing existing policies is also fundamental (*ex post*).**
52. We believe that the **3L3 could indicate how they intend to contribute to the EU Better Regulation agenda**, in particular regarding the 25% net reduction in administrative burdens, as they may be in a position to make a substantive contribution in this area. The EBF informs the 3L3 that it is currently in the process of systematically assessing the elements of “better regulation” embedded with in Financial Services Action Plan (FSAP) and post-FSAP initiatives. The purpose of this exercise is to equip the industry with a tool to better scrutinise the economic and business impacts of initiatives, the results of which will be used in dialogue with legislators at European level.