The voice of banking & financial services

BBA RESPONSE TO 3L3 CESR / CEBS / CEIOPS CONSULTATION PAPER ON THE MEDIUM TERM WORK PROGRAMME

The BBA is the leading UK banking and financial services trade association and acts on behalf of its members on domestic and international issues. Our 235 banking members are from 60 different countries and collectively provide the full range of banking and financial services. They operate some 130million accounts, contribute £50bn to the economy and together make up the world's largest international banking centre.

We recognise the achievements to date of the 3L3 Committees and welcome the opportunity to comment on the Work Programme for 2008-2010. It should be noted that BBA has also contributed to the European Banking Federation (EBF) response.

BBA welcomes the commitment of the 3L3 committees to work together – a reflection of and desired response to the increasing number of financial services organisations that operate across sectors. This cooperation will foster and encourage more pragmatic regulatory responses that we hope will enable our members and the financial services community more widely to free up resources previously employed in overcoming disparities in regulatory responses to risks that are similar cross sector and, instead, to direct these resources towards improving services and innovation that will stimulate growth, encourage innovation, ensure competition and provide consumers with greater choice.

Moreover, our members welcome the ongoing commitment by the 3L3 Committees to continue to engage with industry in achieving pragmatic solutions to identified issues and weaknesses in the regulatory framework. Indeed, timely consultation with the industry will facilitate and enhance achieving the ultimate objective of a single European market for financial services.

Our members applaud the spirit of the work programme, pursuing the momentum achieved to date in seeking to minimise the regulatory burden on cross-border banking groups through greater convergence of cross-sector regulatory initiatives. Whilst keeping in mind that cross-border and cross-sector are of course different issues and solving one may not solve the other.

A Common 3L3 Framework for Cooperation between National Authorities

Our members echo the sentiments raised in the paper that increased collaboration between the Committees will foster the ongoing development of an integrated market for financial services and welcome and support the objective of greater alignment of tools available to supervisors to undertake their tasks. Indeed, we see this work as the foundation to enabling the Committees and their members to achieve more consistent and convergent regulation of cross-border and cross-sector banking groups.

The use of supervisory colleges will enhance this cooperation. Members of the colleges should send suitably empowered representatives, with the appropriate authority to commit to their particular tasks and actions, in order to facilitate expeditious decision making and thereby contributing to the success of the college.

With an eye to the global arena, in which many of our cross-border banks also operate, the 3L3 Committees are minded also to maintain, develop and improve regulatory cooperation and policy development beyond EU borders by engaging with peers in other jurisdictions. In doing so, the EU should seek to achieve a smoothing of the international regulatory framework whilst contributing to further globalization and showing the EU to be a leader in global regulatory development.

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Home / Host

Home / host is a key area for the 3L3 committees if the implementation of MiFID (Markets in Financial Instruments Directive), MAD (Market Abuse Directive) and other directives designed to engender a single European market, are to work effectively. It is vital that there is equal treatment for firms operating the same business from one member state into another. Clearly one of the considerations will be how systemically important any given firm is, but this must not result in significantly different treatment for firms that are substantially the same in nature and the business they are carrying out.

As a central tenet of the single market, the process surrounding the home / host question must be both speedy and transparent. Both the initial arrangements for firms cross border supervision by regulators and any new business lines must be resolved quickly so as to create legal certainty and avoid creating barriers to competition. We consider that transparency of the home / host process at all stages and engagement with the industry is vital to ensure an appropriate and efficient outcome.

Whilst we welcome the 3L3 proposals on delegation of tasks between regulators, this must result in legal certainty for firms. Many regulators cannot legally delegate tasks or rather they may be able to delegate tasks but not the legal responsibility to other Member States competent authorities. As a result, on a risk based approach firms are likely to consider that they must take into account the view of the host and the home state regulator on a delegated task. Until the process of delegating tasks has been shown to work in stressed conditions, firms are not likely to receive the full benefit of this kind of regulatory co-operation.

As part of its drive toward regulatory co-operation CESR has proposed a Q&A on its website, similar to the European Commission Q&A on MiFID. Our members are concerned about the operation and status of these Q&A's. Whilst these tools are useful, the remit and scope of the Commission Q&A has seemingly become much wider than its original basis. The document has become very large and continues to increase in size over time. Our members consider that this kind of Q&A can particularly add value when they are used to provide a description in plain language of what can be very legalistic language of Directives. However the current Commission Q&A is in some of its answers, providing sweeping interpretations of Directives that cut across the financial services industry on a Europe-wide basis. The status of the Commission Q&A is also unclear, firms cannot rely on it when making decisions about how to arrange their business. This issue is going to become more acute when the CESR Q&A is introduced. Members are concerned that these two Q&A's may not be fully co-ordinated and consistent. We would strongly encourage CESR to closely scope the nature of any Q&As and ensure that they are descriptive rather than interpretative in nature. The Commission Q&As are close to producing (de facto) regulatory guidance in a vacuum, without passing through the normal governance and consultation processes. We are concerned that the individuals producing the responses need to be sufficiently close to the issues to provide sufficiently detailed and accurate answers. There needs to be tighter control around which questions are answered, and a clear understanding of the regulatory 'status' of any answers provided by such Q&A sites.

Powers and Enforcement Sanctioning

We support the 3L3 committees review of supervisory and enforcement powers of Member States competent authorities. Embedded within this review must be a process to deal with the double, triple or multiple jeopardy firms face when operating cross borders. This double jeopardy acts as a disincentive for firms to carry out cross border business. The current cross border enforcement arrangements between regulators do not provide sufficient legal clarity as Member States' regulators reserve the right to commence independent enforcement action against firms in their own jurisdiction.

When assessing the suitability and transferability of supervisory powers across their members as well as enforcement sanctioning the 3L3 Committees should pay due regard to ensuring that supervisory powers should be appropriate and proportionate in resolving the risks they are designed to mitigate. The key objective of the review should be to facilitate the further delegation of tasks and responsibilities to support the goals of supervisory convergence and to minimize any duplication that creates uneconomic use of resources within our members. A review of practical issues arising from the colleges of supervisors for cross-border banking groups will expedite this work.

Moreover, our members welcome and encourage reporting to Levels 1 and 2 any legal barriers that would prevent the transferring of tasks and responsibilities amongst 3L3 members.

Inspection Practice Consistency

Our members welcome the drive to create consistency in inspection and supervisory practices between regulators in the EU. We would encourage the 3L3 committees to build on the work that has already been done by regulators to do joint inspections and create convergent standards and practices when supervising firms. As outlined above, our members are concerned about the nature, scope and implications of any potential future Q&A's. Continued work on IT databases for the exchange of information is positive however this should not drive a new set of reporting requirements and standards for the industry. The 3L3 committees should focus on using the existing information they receive from firms and exchanging it in a more efficient and transparent manner.

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

B (i) Competing Products

The Commission has recently published a call for evidence regarding the need for a coherent approach to product transparency and distribution requirements for 'substitute' retail investment products. This is intended to engage with market participants to access if there is any market failure currently present among financial products that could be viewed as substitutes for each other, and simultaneously, perhaps perceived to be competing products. We do not believe it is appropriate for the issue of products assumed to be competing to be placed as a priority for the medium term work programme of 3L3 when the European Commission has yet to consider evidence on this matter. In the context of the Competing Retail Products project the Commission should assess the effect of MiFID (and CRD). The perceived risks might be already mitigated in some parts by MiFID (and CRD). The 3L3 Committees should consider the responses to the Commission's call for evidence, and should assess the MiFID effect (particularly in relation to suitability and disclosures) before launching this any further work in this area.

Whilst we acknowledge that distortion of competition between competitive financial products should be avoided, we do not consider that there has been sufficient technical consultation, or consideration on timing issues, to declare the issue of 'products assumed to be competing' a priority for the 3L3 medium term work programme. We do not consider that there is currently enough evidence to affirm that there is distortion.

It is commonplace to witness a certain degree of cross-over in the characteristics that different financial products encompass. However, this does not imply that these same financial products qualify as genuine competing products, as this is not an objective notion. Financial products have key characteristics which provide the fundamental grounds by which an investor will judge the product in question appropriate or not. Investors will utilise different financial products according to their key characteristics, and ultimately, it is natural that these products will be subject to different regulation, despite the fact that certain characteristics may be shared. Our members would not support the introduction of new regulation to inhibit the very same large choice of products and tools that investors' value in their decision making and chosen investment strategy.

The BBA is concerned that this project has been viewed in isolation from MiFID. We would emphasize that MiFID has brought with it many relevant changes to the pan-European regulatory environment [where MiFID has been implemented], designed to solve, or prevent many of the potential problems regarding competing products highlighted in the consultation paper.

MiFID ensures consumers' risk appetites are properly considered through its' 'suitability and appropriateness' requirements, where responsibility lies with the distributor of the financial product in question. Significant discrepancies in regulation have also been tackled through MiFID's high degree of transparency and disclosure requirements. The impact of MiFID is currently opaque due to its' very recent implementation date. For this, and the aforementioned reasons, the BBA would recommend that this specific issue is temporarily excluded from the 3L3 medium term work programme, until the European Commission's call for evidence is fully completed, and the impact of MiFID on products that are assumed to be competing, can be clearly assessed.

B (ii) Credit Rating Agencies

Firms consider independent, good quality ratings to be an important factor in the transparency and smooth running of capital markets. As such, our members support CESR's desire not to regulate Credit Rating Agencies (CRAs) and to only consider the processes around the methodologies used and the effectiveness of self regulation rather than try to assess the methodologies themselves. Many of our members straddle the 'buy' and 'sell' sides and within our members and across the industry there is a majority consensus for self-regulation of CRAs in the financial community.

CRAs play an important role in the global financial system, with ratings providing a proxy in prudential regulatory frameworks, such as Basel II for the assessment of the credit risk of the underlying counterparty, although it is by no means compulsory for an issuer to get an issue rated. In general terms, this system works well – for instance in Pillar 1 of Basel II, or acting as a haircut for the acceptance of collateral in a central bank's monetary operations.

The use of securitisation has brought significant benefits to the global financial markets, enabling issuers, to diversify funding sources, investors to indirectly invest in a range of different asset classes and, by bringing financial markets and capital markets together, lowering funding costs for individual borrowers.

CESR should recall that CRA ratings on structured finance (MBS etc) only address the probability of default or delinquency of the transaction in question. They do not give any indication of liquidity or market value of these instruments. CRAs must be judged on the terms for which they have been designed.

What is required now is much greater transparency on the number of transactions that have been downgraded, by how much and when the ratings were changed although some transparency is already provided by migration tables. Up to date versions of the rating migrations tables covering the period until the end 2007 are a way of judging the performance and accuracy of rating agencies, but it should be noted that rating agency performance should be monitored over the longer term as ratings relate to longer term assets. By definition ratings that are lower down the scale are both more likely to be delinquent / default but also by their nature more unpredictable and therefore likely to be upgraded or downgraded.

A knee jerk reaction to regulate credit rating agencies should be resisted. It would be both difficult to achieve anything concrete and serve largely to create a distortion in the market. As ratings are merely an opinion about the likely probability of default (they do not assess other risks such as liquidity or interest rate risk), the Credit Rating Agencies' are protected by freedom of speech provisions both in Europe and the USA. It would be a very unattractive option for the market if CRAs' rating models had to in some way be approved by a supervising authority. Similarly setting requirements for staff experience or qualifications (as has been mooted by some parties) would create additional cost and not achieve any practical outcome. In view of this we consider that the best way to consider rating agency issues is through dialogue between the regulators, the CRAs and the financial service industry including potential modification of the IOSCO Code for credit rating agencies. The Credit Rating Agencies question has both prudential and non-prudential aspects. Overall, we do not consider that the CRA project should be high priority currently . We think that on the prudential side, it is the Basel, which is driving, rather than the 3L3, which can actively participate in the Basel discussion, rather than leading it. On the non-prudential side, a lot of work has already been done by CESR. We are waiting for CESR to report its recommendations and conclusions to the European Commission.

Qualification requirements for CRA staff would create further barriers to entry for new rating agencies attempting to enter the market. The best way to ensure accurate ratings and speedy monitoring is competition from other agencies; it would be an untoward outcome if the actions of the regulatory authorities should make it more difficult for this competition to flourish. However increasing the number of rating agencies in the market should not be the overwhelming driver of regulatory change. By its nature the CRA business is one that is not likely to have a great number of players as the time required to build the necessary reputation is so long.

Areas that CESR might consider are the issues around the surveillance and monitoring that go into maintaining a rating. That is, the management procedures surrounding the initial rating and the surveillance of a rating over the months and years of its existence. We suggest CESR should consider:

(i) the seniority of staff who 'maintain' a rating;

(ii) the extent to which CRAs receive all the information they should from trustees on a transaction. To what extent there is qualitative, as opposed to just quantitative, review of that information.

(iii) issues of staff turnover, and the numbers of deals that staff are required to review on an ongoing basis in what has been a rapidly expanding market

(iv) Unsolicited Ratings: Our members believe that unsolicited ratings are a vital tool for new CRAs to build market share and help in overcoming the barriers to entry in this market. CRAs should continue to be able to use unsolicited ratings in an unrestricted fashion.

(v) CESR should not seek to regulate the use of ratings triggers in private contracts or require the disclosure of their use. This is an issue that should be left to the market.

(vi) The provision of ancillary services by CRAs should continue to be allowed within the framework of appropriate conflicts of interest provisions outlined by the IOSCO code.

(vii) Right of appeal: issuers should not have a right of appeal on their ratings. Having a right of appeal implies that there will be a body for the issuer to appeal to. We would not support the creation of such a body. The issuer will already have been given the opportunity to object and or discuss the probable outcome during the ratings process. If the issuer is uncomfortable with the final rating they are able to withdraw their application for the rating to the CRA. Ratings are ultimately the opinion of a private entity and it is crucial the CRAs are able to function independently.

B (iii) Anti Money Laundering and Counter Terrorism Financing

No specific comment

B (iv) Commodity Derivatives

No specific comment

B (v) Cross Border Consolidation

No specific comment

B (vi) Internal Governance

Our members agree that internal governance has a strong role to play in the successful management of any organization. Transmission of MI to inform senior management and the board combined with strong and clear roles and responsibilities and the empowerment of individuals to undertake their tasks effectively are the foundations of a strong corporate governance culture. However, we would question whether internal governance should be included as a key issue for the work plan given recent changes introduced by CRD and MiFID, and the requirements now being developed in the context of the Solvency II negotiations.

Should this continue to be a key priority area then any work in this area undertaken by the 3L3 Committees should give due consideration to the work outlined above and moreover build on and complement existing internal governance guidance such as the *Combined Code* in the UK and the Bank for International Settlements guidelines. If further output is deemed appropriate then it should be principles-based to facilitate flexibility of firms to respond to specific circumstances.

B (vii) Conglomerates and B(ix) Own Funds

Our members recognize and agree that a key focus of the IWCFC should be convergence of the definition of "*own funds*". Developments in this area will bring Europe closer to optimal market functioning. The flexibility provided by a principles-based and outcome-focused response will facilitate and encourage ongoing innovation, help ensure the EU maintains its competitiveness in the global economy and provide a degree of assurance that regulation can keep pace with change. In continuing

the work already underway, the 3L3 Committees are reminded of the work being undertaken at the Basel Committee, and should seek to align conclusions with the outcomes reached there to ensure consistency, as appropriate. Ultimately, an outcome that is one of guiding principles should include a consideration of the purpose for which capital is held.

The work of the IWCFC should remain focused on those issues that are specific to Financial Conglomerates, taking care not to extend its scope to issues that ,may be properly and effectively resolved via either the banking or insurance sectors. Moreover, it would be helpful if the IWCFC more clearly articulated what it is seeking to achieve in its review of the Financial Conglomerates Directive.

B (viii) Capital Modeling

One of the key benefits of Solvency II and CRD is the enhanced dialogue that is encouraged between regulators and regulated as one of their founding principles. It enables regulators to better understand the businesses they regulate and to apply firm specific regulatory responses that recognize specific risk management techniques. Our members look forward to working with their regulators in order to contribute to and ensure the success of this principle and to achieve mutual benefits. We recognize in the early stages of implementation that there will be complexities which is why ongoing dialogue at an early stage is essential. Regulators should rely on industry to identify divergences and loopholes that may not only impact on efficient supervision but also on achieving optimal market functioning. Whilst noting necessary differences in the sectors, wherever possible, these issues should be remedied.

C Developing common 3L3 tools and working procedures within the Committees

Our members welcome any initiatives that further regulatory convergence. The 3L3 Committees should not only seek this within their specific sectors but also, wherever possible, across sectors. It is welcoming and reassuring to see this set out as a specific commitment by the 3L3 Committees in the work programme. Our members consider this a very positive step in achieving greater regulatory convergence and financial integration in Europe.

More generally, our members fully support the Lamfalussy process and its achievements to date. Whilst we recognize there are weaknesses to be resolved, the work identified in this work programme, combined with other initiatives, will help to strengthen many of the well documented weaknesses.

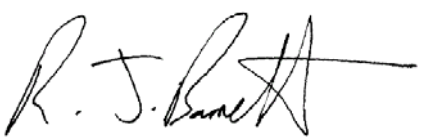
Conclusion

Whilst our members are supportive of the concept of a medium-term work plan, acknowledgement should be made, in our view, of the need for sufficient flexibility to be retained in order to be able to respond to significant new developments, where these impact identified priorities. Where appropriate issues identified should be carefully coordinated with similar work being undertaken in other fora, if duplication and potential conflicts are to be avoided.

To reflect the outcome of the December ECOFIN and its road map, the priorities identified in Section A of the 3L3 work may need to be revisited. For instance, the target for addressing delegation and sanctioning powers in the ECOFIN roadmap is end-2008, whilst the work programme proposes 2009 and 2010 respectively.

If you would like to discuss this response with us please contact Ross Barrett (ross.barrett@bba.org.uk) or John Thorp (john.thorp@bba.org.uk).

Yours Sincerely,



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