



Lamfalussy Chairs - October ECOFIN

Progress and opportunities for better regulation

11 October 2005

Introduction and risk based supervision ***Henrik Bjerre-Nielsen, CEIOPS Chair***

1. Introduction

Thank you for inviting us. We are grateful for this opportunity. It shows to us continued Ministerial recognition of the 3L3 Committees and our work. We hope you will consider the following statements as coming from one voice even though we will be three persons speaking in turn.

We are fully committed to the Lamfalussy model. It works well and we are convinced it will succeed. Our Committees have a number of current initiatives on greater supervisory convergence and effective cooperation. Most importantly we can announce that we intend to sign a Memorandum of Understanding next month to ensure that we continue to work together in an effective manner. This initiative aims particularly at favouring an open flow of information, an early identification of issues of common interest and an alignment of the work on common and relevant subjects.

Our objectives fit well with reducing regulatory burdens on business. However, we believe these objectives are best achieved through an appropriate regulatory framework. Directives such as Capital Requirements for banks and Solvency II for insurers, along with further progress regarding International Financial Reporting Standards, are vital in this respect.

With this start, we then need all regulatory standards to be applied consistently across the EU. As the 3L3 Committees, we agree on this framework and its form. We also share the political objectives behind it. They will be what will help us best to realize our goals. Your support to this end is respectfully invited.

The Committees share a number of pragmatic targets. They increase the effectiveness of the advice we give the Commission, and improve supervisory functions. They include streamlining the supervisory process and developing common approaches to regulatory reporting. My co-Chairs will say more about these. I would like to tell you a little about our work on risk-based supervision.

2. Risk-based supervision

Risk-based supervision requires risk-based regulation. Sensitivity to risks runs through our work programmes. It steers our advice to the Commission and our commitments on the developing framework I have mentioned.

For my own Committee, our biggest challenge is introducing a new solvency regime for the European insurance industry – known as Solvency II. This will bring risk-based provisions to insurance regulation. The challenge is considerable. It is taking up massive resources, not only in CEIOPS, but also in EU Member States and European industry. Its importance is recognized at all participating levels, which we greatly appreciate. The significance for today is producing a balance between regulatory need and business efficiency. This will be achieved through a new risk-based regime. Such a regime obviously relies on risk assessment, particularly by the regulated entities themselves.

The Capital Requirements Directive and Solvency II will both imply a major shift towards a risk sensitive framework, providing incentives to move towards more sophisticated methods for measuring and controlling risks. In their implementation, CEBS and CEIOPS are relying extensively on the notion of proportionality: entities will be expected to develop internal assessments of their risks proportionate to the nature, scale and complexity of their activities; accordingly, supervisors will graduate the depth, frequency and intensity of their review to the risks that each entity poses to supervisory objectives. The notion of proportionality also applies to the framework for supervisory co-operation, in order to avoid unnecessary bureaucratic arrangements and ensure exchanges of information where they are effectively warranted.

It should be added that in the supervision of financial markets, resources can indeed be concentrated on major trading activities. However, for areas like financial fraud and market integrity, the reputation risk for market places is so high that very little can be neglected by enforcers.

In developing our projects we are following the Lamfalussy operational approach to better regulation: transparency, consultation and open debate. The participants range from Ministries and other experts, through to industry practitioners. It is one demonstration of our Committees' commitment to combining regulatory protection with business efficiency. We are working on the basis that this combination is in the best interests of all parties. Over-regulation burdening business – and hence in the end to be paid by consumers - is for us the opposite.

A number of our tasks concern regulatory convergence throughout Europe. Here our Committees practice what we preach, and cooperate extensively on cross-sectoral issues.

This is seen in our cross-sector approaches, including financial conglomerates. All three of us have in hand work that should ease conglomerates' burdens, both national and international. These steps should also reduce burdens on national authorities, without lowering standards. In addition we have argued for a dedicated cross-committee group on financial conglomerates, to take over Level 3 work in this field. This would avoid establishing a fourth Level 3 Committee.

3. Challenges

Despite our best efforts, challenges still remain. We need the top-level regulatory harmonization I referred to earlier. Within European industry, sectors are at

different stages of regulatory evolution. With CEIOPS, for example insurance is more advanced in this respect than occupational pensions or insurance mediation. This partly results from differences in their market-places.

There are also differences among our Members. These include, in their domestic legal standing, objectives and independence, also in their powers and resources. On this last issue, you may be interested to know that CEIOPS is working on giving recommendations on its own initiative to the Commission, as part of our Solvency II project.

Your help in tackling these challenges would be very welcome.

Thank you for listening. I look forward to any discussion after my colleagues' talks.

Streamlining the supervisory process ***Arthur Docters van Leeuwen, CESR Chair***

The Level 3 Committees have been established to ensure that the FSAP directives are implemented in a manner that a real Single Market for Financial Services emerges in the EU as a natural evolution of the current patchwork of national financial markets.

To achieve that, keeping in mind the Lisbon agenda, the Lamfalussy Committees need to have well defined objectives, and proper supervisory tools.

1. What are our objectives?

- Sound and solvent financial institutions and market structures;
- A level playing field that ensures a fair and transparent functioning of markets;
- A high degree of trust that can only be obtained through ambitious investor protection and rigorous enforcement to preserve market integrity.

There is today a tendency to forget these key objectives and have them mixed, if not obfuscated by “working method” objectives (the need to reduce burden, diminish compliance costs). The international credibility and investors attractiveness depends on how we achieve these key objectives. The reduction of burden should be in regulators minds to find competitive solutions and should be pursued without undermining stability, transparency as well as investor and policyholder protection.

2. What are our immediate needs to make the FSAP work?

At this juncture, to be successful, there are two key issues for which we need ministers’ support and political backing.

Equivalent powers

You have decided to create a system by which a supervisor mutually recognises and relies on the decisions of its’ fellow colleagues. But no credible Home/Host relationship or Network of supervisors can work if the supervisors are not given the necessary equivalent powers to act and cooperate. The FSAP directives have improved the situation. In the area of banking, the degree of equivalence of supervisory powers is satisfactory, this is less so in the area of securities and insurance. Member States have the responsibility and a key role to play here. Equivalent supervisory powers are a prerequisite for any kind of EU supervisory system to work.

IT Networks

Increasingly the Level 3 Committees, in particular CESR, are regarded as natural places to develop IT facilities to assist the supervisors. These IT systems can be relatively modest (like databases of cases) or require a more structured design and capacity (exchange of transaction reports/access to financial information of 7000 listed companies). These IT tools significantly reduce the costs of supervision and administrative burdens. However, they must be financed by Member States who should provide their respective supervisory authorities with the appropriate resources to develop these IT facilities.

3. Further steps for supervisory convergence and streamlining of processes

The objective here is that each of the national supervisors “think European” before deciding. The fact that we work together in the Lamfalussy committees favours immensely a common culture, in particular through: similar supervisory approaches, common and predictable attitudes, shared supervisory techniques and process as well as operational enforcement networks. The Committees are also promoting a common European supervisory culture by developing initiatives for staff training programmes and for exchanges of staff between authorities.

More can be achieved to enhance convergence and mutual trust by using more systematic peer pressure and review of practices. In the area of securities, we are exploring the use of CESR as a “mediation facility” to help to find solutions where two or more supervisors disagree.

Financial groups have been undergoing significant restructuring in recent years. The operational structure of cross-border groups no longer automatically coincides with its legal structure, on which the division of responsibilities between national supervisors is based. Moreover, large and complex groups may well pose a systemic threat in host markets. This calls for extensive co-operation between home and host authorities, with extensive and two-sided exchanges of information. The approach the Committees are following is very pragmatic and does not intend to build up unnecessary bureaucratic machinery: the co-operation framework is graduated in relation to the significance of each component of the group and is expected to be proportionate to the risks involved. In banking and insurance, these efforts are being built around the notions respectively of a consolidating supervisor and a lead supervisor. In the area of securities the situation is more diverse due to the variety of market participants involved; here it is worth exploring delegation of powers.

Depending on the degree of integration of the Single Market and the success of the voluntary supervisory convergence, the most cost/efficient supervisory solution can differ significantly. We favour a pragmatic bottom-up and adaptive strategy for the designing of an EU Supervisory system. But this discussion should not be unprepared. This is why we are very supportive of the work going on at the FSC and of the Commission’s Green Paper . We welcome in particular your intention to have an informal discussion on this matter next spring.

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All in all, the conclusions you have today before you are the right ones. The Lamfalussy Committees can significantly streamline the supervisory process in Europe. But it will not work if national supervisors cannot cooperate with each other: for that they need equivalent powers. The streamlining of processes also needs the development of IT Networks: for that, supervisors need the resources to create and run these systems.

Common approaches to regulatory reporting

José María Roldán, CEBS Chair

1. Background

The overlap and lack of a common approach to reporting requirements for financial groups operating cross-border businesses can be an unnecessary administrative burden, disrupting cost savings that should flow from a more integrated financial market.

Market participants can be required to supply similar information to different supervisors in different formats. Any change in reporting requirement will entail some cost and this must be set against the potential benefits. Market participants having a predominantly local focus may be unhappy at adjusting reporting systems for the benefit of cross-border operators.

However, the implementation of FSAP measures, including new international accounting standards, the Capital Requirements Directive and Solvency 2, provide the EU with a window of opportunity to move towards more a more consistent approach. The implementation of this legislation will mean reporting systems will have to be adapted in several areas and in all Member States.

For the purpose of market integrity surveillance, transactions reporting obligations have been significantly simplified by the Mifid. Despite the fact that there will be a multiplication of trading places, firms will declare trades only to their home competent authority. What remains to be done is the exchange of reports between authorities.

2. Work under way

Efforts are under way to develop a common framework across sectors for reporting of the solvency ratio and a standardised framework for prudential reporting of financial data. Extensive public consultations have been conducted and we still are in a phase of intense dialogue with the industry.

As a result, banking groups operating on a cross-border basis should face a lower administrative burden. Smaller local banks should not be subjected to additional costs as the reporting framework has to be updated in any case (IFRS/CRD). We need to develop a level playing field.

IFRS provides with a single set of accounting standards for all EU listed companies. CESR is developing supervisory convergence tools to ensure that consistent interpretation of IFRS is given throughout Europe, so as to provide issuers with similar responses and avoid multiple compliance requirements.

Exchanges of information between supervisors should also be facilitated, allowing them to achieve cost-effective and efficient supervision; this will contribute to financial stability and market integrity in the EU.

The insurance sector is deeply involved in Solvency II, the creation of its new future prudential regulatory environment. The project necessarily includes steps towards harmonising reporting requirements as part of the overall regime.

There are difficulties in achieving greater convergence of insurers' reporting requirements before Solvency II. They include a lack of international accounting standard for insurance and the outstanding differences between Member States' home supervision regimes. However, we are analysing any possible improvement that could be achieved in the short term and stands up to a cost-benefit assessment.

3. Obstacles and challenges

National authorities move from fairly different starting points, as differences in reporting mirror different supervisory practices. For instance, some national supervisors rely more on comprehensive reporting of data and off-site surveillance, others on on-site inspections, others rely more on the information stored in the internal systems of the supervised entities. There are differences in human and technical resources and in the structure of supervisory processes. A lot of work has been done and much progress is being achieved, but one has also to be realistic: we cannot change supervisory practices at once by harmonising the reporting framework.

Different authorities ask for data in order to pursue different objectives (e.g. prudential monitoring, checking compliance with conduct of business rules, analysing potential threats to financial stability, pure statistical requirements). It is not an easy task to reduce this down to a simple set of requirements. In any case flexibility is required, as some authorities have to increase their requirements, while others can decrease the amount of data required when the supervisory methods are converging.

We are working via consensus, with soft tools that are voluntarily implemented by national authorities. If several layers of reporting requirements are added at the national level and too little commonality is achieved at the EU level, we will have to reconsider our work and consider whether regulatory harmonisation is needed.

We also have to keep in mind that moves towards a common reporting framework might be costly at first (e.g., because of change in the IT platforms), while the benefits would be gained only through time.

In spite of these difficulties, market participants maintain very ambitious targets: they ask for a very simple framework, reducing substantially the total amount of information to be reported, and for complete uniformity throughout the EU, i.e. full convergence towards a minimum set of requirements. Especially if we consider that we are moving towards much more sophisticated and risk-focused approaches, these requests do not seem realistic until convergence has been achieved.

The work we are conducting tries to strike a balance between all the different interests at stake, providing for a good degree of standardisation but also leaving some room for national flexibility. Transparency of the framework should allow initiating a process which will gradually lead to further convergence, but it is a very complex and resource intensive process.