



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

BCBS Consultation Document on Home-Host information sharing for effective Basel II implementation

A response by BBA, ISDA and LIBA

We welcome the Basel Committee on Banking Supervision's Consultative Paper on home-host information sharing for effective Basel II implementation, which is based on the experience and ongoing work of the Accord Implementation Group (AIG). It recognises the necessity of effective communication between regulators if Basel II is to be implemented in a cost effective and consistent way, for regulators and our members alike.

We whole-heartedly support the general principles on information sharing which should serve to improve the broader understanding between regulators, and increase mutual trust. We expect enhanced cooperation between regulators to lead to an eventual reduction in the regulatory burden on our members without any increase in risk to depositors or to the financial system. Nevertheless, we believe that certain refinements or extensions to the principles are necessary. Our response focuses upon the following key elements:

- The supervisory relationship should focus, to the greatest extent possible, on the consolidated group rather than levels below that.
- The Pillar 2 dimension in home/host relationships needs to be elaborated.
- An acknowledgement of the role the supervised group itself can play in identifying the most efficient role of the supervisors
- The need for a greater emphasis on the relationship between supervisors themselves, notably the increased use of colleges of supervisors

Context of our remarks

We support the work that the AIG is undertaking to encourage information sharing amongst regulators in order that a supervisory interaction can be focussed at the group level to the extent permitted by law. Naturally the maintenance of good relationships between the host regulators and local subsidiaries and branches is important, and will continue to be so. However, focusing the relationship with and channelling information through the home state regulator, wherever possible, should reduce cost without significantly undermining local relationships.

Banks and investment firms operate in an increasingly integrated global market, offering financial services across borders through subsidiaries as well as branches. Multinational firms manage bilateral relationships with a number of different regulators and are in a unique position to observe when regulators' actions and approaches are inconsistent or duplicative. This duplication diverts resources from the business of risk management - the primary source of protection for our customers and counterparties - and undermines the Basel II objective of encouraging better risk management.

Our members recognise the benefits that a more harmonised and convergent global regulatory architecture can bring and actively encourage regulators to co-ordinate their activities, whether or not there is a legal requirement to do so. This will lead to a more efficient use of supervisory resources and lower compliance costs – which are ultimately borne by the consumer.

Application of Principles to Groups

We are delighted that the paper recognises the need for even greater emphasis on coordination between the regulators of each multinational financial group. It is our firm belief that financial groups should be understood and regulated as groups. Banks and investment firms within a financial group are, by necessity, closely linked, and the group is for almost all purposes the most relevant unit. While the management of each company retains responsibility for measuring and managing the risk profile of that company, groups are predominantly managed on a group basis because it is both more efficient and safer to operate in this manner. We understand that host state regulators will want to understand a firm's Basel II implementation plans, irrespective of any legal obligations to do so. But Basel II implementation plans are developed and coordinated primarily at the group level - for good reason – and we believe that the language in the Consultative Paper could emphasise this dimension more strongly still.

Application of Pillar 2 to Groups

The benefits of regulatory coordination are greatest in the context of Pillar 2 and we were disappointed to see the relatively cursory reference to Pillar 2 in the Consultative Paper (paragraph 20). This brevity may reflect a lack of development of supervisory thinking at international level on the application of Pillar 2, but it is important that supervisors turn their attention to this major area of Basel implementation. Flow of information to regulators and between regulators in this field is likely to be much less standardised than in the Pillar 1 context, and the potential for very disparate expectations regarding relevant or complete information seems high.

Our members are particularly concerned about coordination of Pillar 2 activities and the current lack of clarity, in some jurisdictions, about the level at which Pillar 2 will be applied. Firms recognise that in some jurisdictions there are legal obligations to apply Pillar 2 at an entity level. However, because groups are managed largely on a group basis, application of Pillar 2 at the level of the individual legal entity (which we are pleased to see the paper does not advocate), or indeed at any level below that of the group, cannot deliver an accurate or complete view of risk management practices. Given the clear advantages of group-wide risk management, the application of Pillar 2

requirements at levels below the consolidated level appears at best disproportionate to any possible prudential benefits, and at worst harmful.

Where such legal obligations exist, the question arises of whether or not a subsidiary or sub-group may be required to develop its own separate, duplicative, Pillar 2 approach. The alternative and preferred option would be for the host regulator to ensure that the Pillar 2 requirements are satisfied for the subsidiary/sub-group by assessing the relationship of the subsidiary/sub-group to the wider group's Pillar 2 processes. The second bullet point in paragraph 22(ii)¹ appears to imply that this alternative could be acceptable. It should be.

Collecting and sharing information

The keynote of the Consultative Paper is information sharing for effective Basel II implementation. An essential goal in the context of information gathering is that firms should not be overwhelmed by multiple overlapping, or even contradictory, requests for information from regulators.

We therefore recommend that, so far as possible, implementation information requests should be directed to the home state regulator, not the local subsidiary. Information should be collected by the home state regulator and then distributed, as appropriate, to host state regulators. Ideally the home state regulator should therefore be the only point of contact for the host state regulator – other than in very rare instances. Information concerning a subsidiary's Basel II implementation plans should be sought directly from a firm by a host state regulator only after reference to the home state regulator.

This proposal does not, of course, absolve the local management of the subsidiary from understanding the capital requirements and risk profile of the subsidiary they manage (paragraph 3). The responsibility for understanding how roll-out plans fit in the overall group plan, data issues and where and how readiness gaps are being addressed remains. We therefore think that much of the information specified in para. 22 (i) could be moved to the categories of information that could be supplied by the home state regulator listed in para. 22 (ii).

We also agree that the extent and frequency of information sharing should depend on the significance of the entity concerned.

Where a subsidiary is large in the context of the host state financial system, host state regulators will wish to have a direct relationship, but even in such circumstances there are significant benefits to the coordination of information and we encourage dialogue between home and host regulators to determine the appropriate approach.

¹ "The bank's plans for meeting its responsibilities under Pillar 2 and how its approach at the global level will be applied locally to meet any local Pillar 2 requirements."

Regulatory Coordination

The principles proposed by the AIG that govern information sharing and cooperation in the Basel paper draw much inspiration from the High Level Principles for the cross border implementation of the new Accord. We support the principle that the home state regulator should co-ordinate the roles of the home state regulator and the relevant host state regulators. Additionally we particularly welcome the emphasis on the need for pragmatic, proportionate and flexible behaviour on the part of the group of regulators involved in supervising a group (supported by high level principles 4 and 5).

We also support the principle that supervisors should communicate the roles of home and host regulators to firms as clearly as possible (para 8 and high level principle 6). Effective cross-border relationships and successful consolidated supervision require a clear, shared understanding of respective responsibilities.

In our view, however, the principle of coordination needs to be developed further. We strongly recommend that the group entity being supervised should also be involved in shaping the roles of different regulators, rather than just being informed after the fact of a regulatory decision about role allocation. Involving the firm itself will lead to better information on which to base those decisions. Our member firms recognise that they are responsible for ensuring that group legal and management structures are transparent.

The College of Supervisors

We support the suggestion that greater use should be made of multilateral contacts. Those of our members who have been involved in regulatory colleges have welcomed the dialogue these colleges have catalysed. Their experience is that supervisory colleges improve the information on which regulators base decisions, reduce duplication and inconsistency, improve subsequent bilateral dialogue between regulators, and increase levels of trust. Our members strongly believe that such colleges should become an established and routine part of the supervision of cross-border groups. The scope of regulatory colleges over time can usefully extend beyond Basel II implementation issues to supervisory concerns in general. Equally, our members believe that colleges should be established for a greater number of groups.

Home and host supervisors, with differing objectives and information, may be expected to disagree on occasion. There should be procedures to air such disagreement (without expecting that in every case discussion will eliminate disagreement). We suggest that there should be simple procedures by which both information requests and supervisory decisions may be subject to informal challenge by other regulators with a legitimate interest – i.e., in foreseeable cases, by the home state regulator (consistent, of course, with each authority retaining the final word over matters within its legal competence). In our view a supervisory college provides an effective forum for identifying and understanding differences between regulators – although it maybe that such differences will be resolved bilaterally.

For example, where a host state regulator believes that a subsidiary warrants more intensive supervision of its activities than either the home state or the firm itself believes necessary, we encourage regulators to try to ensure that the degree of regulatory

involvement and scrutiny of the host state regulator with a subsidiary/branch is proportionate to the significance of the firm in the jurisdiction.

In order to improve the use of regulatory resources and to reduce a firm's regulatory burden we strongly support the statement that visits by the home state regulator should be planned and co-ordinated jointly with the host state regulator.

Conclusion

We welcome the Basel Committee's increasing focus on the importance of home-host information sharing. We encourage the AIG to continue with its work.

We believe much of the information on Basel II implementation will be held at the group level and can more efficiently be collected at that level. In most circumstances, it will be most efficient for host state regulators to acquire information from the home state regulator rather than from the group. Conversely, it must be the home state regulator's responsibility to share the relevant information with those host state regulators with a legitimate interest in that information.

The College of Supervisors approach has many merits, not the least of which is the direct and active involvement of our members in the shaping of the supervisory process. We encourage the development of this approach and its extension to other groups. Our members stand ready to play their part in this.