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28 October 2005

The Committee of European Banking Supervisors
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Dear Sirs

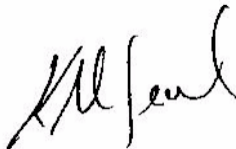
The London Investment Banking Association (LIBA), and the International Swaps and Derivatives Association (ISDA) are grateful for the opportunity to comment on CEBS' consultation on its role and tasks. This is an important consultation and we appreciate the commitment CEBS is demonstrating in its desire to interact as effectively as possible with industry as well as the regulatory community. Our commentary represents the views of both trading firms and banks. Our key messages are discussed in the body of our response paper. However, we wish to highlight two themes in particular:

Scope of application Firms urge CEBS to place a stronger degree of emphasis on relationships and coordination with third countries. Industry also encourages CEBS to highlight the cross sectoral dimension of prudential regulation so that the relevance and applicability of CEBS work is as apparent to investment firms as it is to the pure banking sector.

Practicalities Firms appreciate the practical and open approach adopted by CEBS. Although there are aspects of organisation that could usefully be enhanced, firms recognise the genuine willingness of CEBS to engage with industry. The most urgent development our members seek is clarification of the status of CEBS' guidelines, which, as we have indicated in other recent responses to CEBS' consultations would be welcomed.

Finally our Members look forward to the continuing evolution of CEBS working practices and hope there will be scope for further discussion. Please contact Katharine Seal (Katharine.seal@liba.org.uk) and Ed Duncan (eduncan@isda.org) if you would like to discuss any of the aspects of this letter.

Yours faithfully,



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Director, LIBA



Edward Duncan
Director, ISDA

**London Investment Banking Association
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Response to CEBS CP08

28 October 2005

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Introduction

Industry broadly welcomes and supports the main objectives, tasks and tools that CEBS sets out in its paper. Our members particularly welcome the opportunity to enter into dialogue with CEBS on how best these important roles and objectives may be achieved.

LIBA and ISDA continue to support the Lamfalussy process as strongly as possible and applaud the energy and style of openness that CEBS has been fostering in its activities as a Level 3 Committee.

The main issues that our firms wish to bring to CEBS attention in the context of this Consultation, and where we believe that practices may be enhanced, are noted in the first section of our response, with more detailed comments following sequentially.

Key messages

(I) ORGANISATION

- ❖ **Consultation practices.** Overall, industry welcomes the strenuous efforts that CEBS has put into making its consultative processes as open as possible. CEBS is regarded as well disposed towards industry practitioners and also as being an effective Level 3 Committee. Yet there are improvements that could be made. Industry has not, in general, found the consultative panel process to be transparent or accessible. This experience may reflect the fact that panel members act in a “personal” capacity, rather than as formal industry representatives. We urge CEBS to consider the following aspects:
 - Greater access to the Committee via consultation and practitioner panels, e.g. through transparency on meeting dates, agendas and papers.
 - Greater degree of feedback, both written and via industry meetings
- ❖ **International Coordination.** Industry would appreciate greater international coordination and alignment of regulatory projects. Although CEBS cannot achieve full coordination unilaterally, firms ask that CEBS as a body, as well as the individual regulators within CEBS exert maximum pressure to ensure that multiple international consultations on the same or similar subjects are avoided. Additionally we would encourage CEBS to take the initiative to avoid overlapping/duplicative information requests made to firms by different regulators as far as possible.
- ❖ **Prioritisation.** At present firms do not feel they understand how CEBS prioritises its work. Industry welcomes the fact that the implementation of the Capital Requirements Directive is driving the general agenda but it is less easy to determine how more specific priorities are set within this context. Greater transparency would be valuable. In addition firms believe that the overall process of convergence would be enhanced if the industry were able:
 - to propose issues to CEBS; and
 - to indicate what issues industry sees as highest priority.
- ❖ **Forward Agenda.** Firms would appreciate greater information on CEBS’ forward agenda, in both general and more specific terms, in order to better allocate and plan resources. Firms support all CEBS’ communication strategies, but believe this further level of development would be a vital improvement.

(II) CEBS’ GUIDELINES

- ❖ **Status of CEBS’ Guidelines.** Industry needs clarity on the status of CEBS’ Guidelines. Although CEBS’ documents represent a valuable consensus view of the EU regulators, it is not yet clear to industry whether or to what extent firms can rely on CEBS guidance. This is leading to decision paralysis in CRD implementation projects. Individual regulators within CEBS must make public how, and in what way, and to what extent they will make use of CEBS publications.

(III) SCOPE

- ❖ **Non EU Dimension** For the EU to achieve its greatest potential as a single market, its relationship with non-EU countries needs to be taken into account. Firms ask that CEBS focus on regulatory relationships with third countries and seek to achieve in as pragmatic and as practical

manner as possible, the collaborative and cooperative approach that informs relationships within the EU.

- ❖ **Cross Sectoral Dimension** It is disappointing that CEBS' terminology refers exclusively to banks and to banking and we ask CEBS to remedy this. Prudential regulation applies to investment firms as well as to banks. Moreover this cross sectoral dimension underpins the need for strong relationships between the Level 3 Committees.

(IV) **TASKS AND TOOLS**

- ❖ **Tools** Firms believe that there would be much merit in CEBS seeking a mediation role, where differences exist between regulators in the prudential arena. It is inevitable that differences will emerge when regulators assess cross-border groups and CEBS' convergence mandate could be used to good effect in a mediation capacity. Firms do not recommend that mediation between a regulator and a firm could be carried out by CEBS.
- ❖ **Tasks** Our members wish to support CEBS in its tasks to the greatest extent possible. However, our membership differentiates between the importance of these roles and suggests the following order of priority:
 - Promoting a consistent approach to banking supervision
 - Cooperation and information sharing
 - Contributing to effective EU legislation

Detailed comments on CP08

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I Framework and Market Trends

- **Support for convergence**

In general firms support the analysis and industry welcomes greater and more efficient cooperation between regulators. The move towards convergence of approach between supervisors marks a significant shift in regulatory philosophy which firms appreciate as it should facilitate consistency of treatment between firms in the context of increasing cross border business, consolidation and centralisation of business. Achieving progress in delivering a consistent and streamlined approach could be a significant success for CEBS. We wish to draw attention to the following issues, some of which are also relevant to other recent CEBS consultations.

- **Misalignment of industry and regulatory structures**

Firms strongly welcome CEBS' recognition that the Home-Host regime within the EU is increasingly misaligned with the centralised operations of cross border groups. The trend in group organisation, which is frequently encouraged by supervisors for reasons of enhanced risk management control, will only increase, and puts an onus on the regulatory structures to find an efficient way in which to respond. It is important and welcome that CEBS recognises not only that there is a home-host dimension to consider, but also that regulators understand and engage with the cross-sectoral dimension.

- **Importance of the 3rd country dimension**

One element of the cross border analysis appears to be under developed, however. It is disappointing that so little emphasis is given to relationships with jurisdictions outside of the EU. Whether European firms are expanding beyond the Member States, or global firms are attracted to do business within the single market, the third country dimension must be considered in all CEBS workstreams. At a minimum we can hope that convergence of approach between EU regulators will set a powerful precedent for other global regulators, but it must also be considered that there will be useful lessons that it might be possible to glean from outside the EU.

Industry would be glad to receive feedback from CEBS on what role the Committee foresees in terms of being a focal point or conduit of relationships and exchanges with 3rd country regulators in the field of prudential supervision. In order to be clear, industry does not expect EU institutions, whether CEBS or the Commission, to "negotiate" on behalf of the EU unless all Member States were to support such

an approach. However, there is a distinct opportunity for CEBS to take a leading and facilitating role. It is increasingly clear that many third country regimes are looking to CEBS output for guidance and example, so the more CEBS can do to facilitate pragmatic exchanges with third country regulators.

- **Conflict of interest between cross border and domestic firms**

We note that CEBS contemplates the possibility that the existence of purely national firms may mean that full uniformity of supervisory approach in the EU is unnecessary. Were industry to support the CEBS analysis to its logical conclusion, it would create a stepping stone to a two tier system of supervision whereby converged supervisory practices applied to cross border entities and more national practices applied to purely domestic concerns. However, there is a level playing field dimension which needs to be considered, as national firms do not operate in isolation from cross border interests. The two sets of firms will be in competition with each other, although the extent to which the target markets overlap will be likely to differ between Member States. Given that the CEBS proposal indicates that firms in direct competition could be subject to different supervisory practices it is essential to provide explicit reassurance to industry that the application of domestic or converged supervisory practices will have only neutral impact on the competitive interests of either group of firms.

2 CEBS' objectives, tasks and tools

- **General Principles**

Industry supports the General Principles that CEBS sets out and wishes to draw particular attention to the following points:

We agree that financial regulation must adapt quickly and facilitate integration and that supervisory tasks are usually best performed close to the entity, but we also welcome the stress that CEBS places on the need for strengthened cooperation to respond to cross border and cross sectoral groups. Without this recognition, there is a risk that domestic interests could remain paramount. It is particularly welcome to see the emphasis that CEBS places on its relationships with its fellow level 3 supervisory committees within the Lamfalussy structure. Only in this way can CEBS fulfil its desire to act as a single market enabler and promote financial sector stability.

In particular, firms support the operating principles CEBS has set out of:

- Good practice
- Efficiency
- Effective regulation
- Level Playing Field and proportionality

With respect to the principle of proportionality, firms emphasise that proportionality must be assessed from the point of view of the impact on the firm, i.e. the genuine cost to firms.

Industry agrees with the necessity of placing CEBS under the *obligations* of:

- Consultation – consensus building and buy in from industry and end users; and
- Accountability and transparency – European Parliament, European Commission, and Council.

Firms agree that there should be both accountability and transparency towards the EU institutions. However, the principle of transparency should also apply in respect to CEBS relationships with industry. We believe that this concept extends beyond the willingness to consult and build consensus between industry and regulator.

We also note that CEBS also wishes to promote stability and sound risk management practices. We are very concerned as to what CEBS intends by this statement and we would be grateful for further elaboration.

Are CEBS objectives and considerations sufficient – or should they be amended or enlarged?

Please refer to our comments in the text above.

- **Contributing to effective EU legislation for banking sector**

CEBS states that it seeks mandates which go beyond pure information gathering and further notes that the Committee wishes to provide advice at its own initiative. Industry recognises that CEBS' role in contributing to effective EU legislation could, in principle, be crucial to the quality of future legislative initiatives in the field of prudential supervision. The supervisory authorities, like industry, are in a good position to identify emerging trends, shortcomings in existing regulations as well as to understand and advise upon the practical implications and constraints of forthcoming prudential legislation. However, firms believe that the wider form of mandate that CEBS might be given by the Commission would, in order to be fully informed, need to be accompanied by an effective consultation procedure by CEBS.

CEBS envisages two scenarios in which the Commission seeks advice. According to the first scenario, namely touching upon general principles and political guidance for Community legislation, CEBS envisages supervisors offering advice without taking the view of the industry. Under the second scenario CEBS indicates that consultation with industry would be necessary when offering advice on more technical issues.

Firms agree that CEBS should be able to put forward its view to the Commission both on political issues as well as technical issues. To the extent possible, it would be helpful if CEBS were to ascertain industry views on the more political issues, not least as this would add gravity to the regulatory position and act to ensure that the industry view was not obscured.

- **Promoting a consistent approach to banking supervision**

General Support for CEBS' approach

Industry supports the CEBS' commitment to eliminate unnecessary inconsistency of supervisory approach. Hence, firms support both the objectives of consistency of supervision and the means by which CEBS will seek to achieve such consistency. Although there will be some degree of tension between facilitating integration and respecting diversity, the momentum towards a consistent and proportionate approach can only be welcome. Nevertheless, in order to be effective it is necessary for CEBS to go further than identifying its tools.

Status of guidelines must be made clear

Much of CEBS' initial work has been to try to establish guidelines and common approaches. However, this initiative is, at present, currently being undermined by the lack of definition of the status of its output. In principle firms agree with CEBS' optimism that the level 3 committees' outputs will be successful because they are Consensus based, not externally imposed, but internally generated, permit cross fertilisation of knowledge and experience in regulatory authorities via the process of creating guidelines and because supervisory disclosure will be applied. However, each individual firm and group of entities in all of the EU Member States **needs to have an unambiguous understanding of how its relevant supervisors relate to the guideline**: whether and if so to what extent will the supervisor base their implementation upon the consensually agreed guidelines; in what timeframe will the guideline be implemented? In other words firms need much more specificity from regulators in the manner in which the regulators will use the guidelines and therefore how much weight an individual firm can place on the CEBS guideline. Knowing that the guidelines are a reference point is insufficient and creates a damaging degree of uncertainty for firms in their own implementation programmes.

Consultation Practices

More time is needed before the impact of CEBS work can be properly assessed. However, industry applauds CEBS' "strong commitment to consult." For its own part, industry offers CEBS its own commitment to participate fully and constructively in responding to CEBS consultations. Industry wishes to work with CEBS as closely and collaboratively as possible, recognising that for both industry and regulators, the consultative process represents a major expenditure of resources. Therefore it is all the more important to ensure that the maximum value can be extracted from the process. Firms, in particular, welcome the indication that CEBS wishes to avoid consultative bottle necks, while recognising, as during the summer period of August 2005, when no fewer than five CEBS' consultations were active, that this is not always possible. However, firms ask that CEBS gives full consideration to

announcing its forward agenda as soon as possible, and for involving firms in the process of identifying the priority issues on which to consult. Announcement of the forthcoming work programme and consultations – as in the FSA’s Handbook Notices – is a very simple but valuable tool of communication and has proved extremely valuable to firms in their planning.

A further angle to be considered in CEBS’s consultative practices is whether there are other international bodies who are also consulting on the same or very similar issues. Multiple consultations from different sources on essentially the same topic are an inefficient use of regulatory and industry resources. Where duplicate or overlapping consultations are necessary it is important to explain why this is so, and also to discuss how the future guidelines from the various bodies will fit together.

Consultative Panel

Firms are aware that a Consultative Panel for CEBS has been established, but at the present time, this panel appears to be remote and it is not clear to industry whether, or in what way the Panel is articulating “industry views.” Greater transparency on the contact between CEBS and the Panel would be welcome. Although minutes and conclusions are available, these records are necessarily backward looking and the accessibility and accountability of the Panel appears limited. On a highly practical note, advance notice of issues to be considered by the Panel would be an important addition to the openness of the dialogue to ensure that the Panel is able to represent a wide industry view effectively.

Another issue is the composition of the Panel. The Charter of the Panel makes it clear that many sectors and aspects must be considered by those who nominate members, but it is not clear that the investment banking activities of the single market are fully represented on the panel. Investment banking spans both the banking and the investment firm sectors and cannot be considered in a purely “vertical” sectoral manner. Hence, there is a concern among our Membership that CEBS is not as equipped as it needs to be in order to appreciate the cross sectoral dimensions which its work in prudential regulation demands.

Developing standards in areas not covered in EU legislation

Industry notes that CEBS will work towards developing standards in areas not covered by EU legislation. This process is important if a meaningful convergence is to be achieved through the EU. Inevitably, CEBS will deploy its own initiative in identifying which areas should be acted upon but it is also important to give industry the opportunity to express its views on which areas would benefit from such development. In some cases, it may be most desirable for CEBS to conduct research before planning any initiative of convergence which would entail a degree of policy development. It will also be essential to consult industry at the earliest opportunity – and certainly before the regulatory community has any form of fixed view so that the consultative process is genuinely consultative.

• **Cooperation and information sharing**

Effective cooperation and information sharing between supervisors is, inevitably, the basis upon which effective supervision of cross border groups will be conducted. Needless to say enhancing information exchange and cooperation does not of itself ensure the full and effective supervision of cross border groups, as there has to be a conscious effort to identify whether practices are indeed efficient for firms and regulators and also to ensure that information requests to a firm are minimised. Otherwise there is the distinct risk that information sharing could be partial and indistinct/lacking appropriate clarity. However information and cooperation improvements are a necessary minimum and the tools identified by CEBS are practical.

• **Other possible tools**

Broadly, firms support CEBS’ analysis. In particular, that its primary focus is to build a common supervisory culture and approach, emphasising a practical and cooperative style. Nevertheless, when considering which tools CEBS employs, it is important to review tools used by other Level 3 Committees. Although the focus of the different committees is not identical, similar tools may still be of value.

To the extent that the following tools are not already available to CEBS, firms encourage CEBS in the strongest possible terms to acquire or develop such tools:

- to ensure an annual review to reassess the CEBS work programme, progress and impact and need for flexibility;
- to develop thinking and elaborate upon a Peer Review approach.
- to develop thinking in the field of mediation and delegation of tasks. The implementation of the CRD will require the effective operation of home-host relationships and CEBS needs to be able to support these relationships as strongly as possible, encouraging delegation wherever possible and standing ready to mediate between regulatory authorities where necessary.

Although CEBS is currently aiming to assess the efficiency and effectiveness of its current set of tools, is there a pressing need to expand this to include those outlined above?

Please see above text. Industry would welcome developments in particular with respect to Mediation and Peer Review within the course of the following year.

3 Evaluation and assessment of progress

Industry agrees that CEBS will need ongoing evaluation and assessment programmes. An annual review of the work programme is a good starting place, and the wider context will be supplied by the 4 year review by the Inter Institutional Monitoring Group (IIMG).

Firms offer particular support for CEBS' desire to identify the impact of its work and the assessment of perceptions of stakeholders, although it is not wholly clear in what manner CEBS will seek to obtain this feedback, and greater information on this point would be welcomed.

Industry is strongly behind the need to identify future priorities and believes also that this process needs to be more transparent than at present.

Industry agrees that CEBS answers to a number of bodies who have the right to request work and seek help. Moreover CEBS' ability to react quickly to urgent requests is essential and its resources are restricted. However, it is not clear how CEBS intends to "assess the ability of each product to meet its intended objectives."

What (other) specific monitoring tools should CEBS adopt now to ensure that it can adapt to changing demands and priorities, and meet its objectives in the short and longer term, for example specific surveys conducted with the help of the Consultative Panel. Or should this be considered later, after the Lamfalussy review?

Industry endorses the annual review process for CEBS which we believe will be a powerful tool. An enhanced process for identifying objectives and setting priorities must go hand in hand with any monitoring of CEBS' activities, however, as discussed earlier in the paper. Firms would, in principle, support the use of surveys but suggest that the audience is wider than the existing consultative panel. Waiting until the Lamfalussy review would not suggest urgency in CEBS' own desire to understand whether it is communicating successfully with its constituency or is perceived to be achieving its stated objectives.