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**Subject: EBF considerations on the strengthening of European financial services
supervisory arrangements**

Dear Mr de Larosière,

I wish to thank you once more for the opportunity offered to the European Banking Federation on 19 December 2008 to share with you and the other members of the Commission's High-level Group our considerations regarding the reform of the EU financial services supervisory architecture.

As I already set out during that breakfast meeting, the EBF believes that the review of the current prudential supervisory architecture should take as a starting point the ultimate objective of achieving a pan-European financial supervisory framework to support a single financial market. In any future pan-European framework the prudential supervision of each institution should be consistent across countries and proportionate to the degree of systemic risk.

Colleges of supervisors, in our view, have an important role to play in reducing regulatory duplication and inconsistency, to improve bilateral dialogue between regulators, to increase levels of trust, and enhance the cooperation of supervisors. Colleges of supervisors should be supported by better-resourced Lamfalussy Level 3 Committees CEBS, CEIOPS and CESR at the micro level.

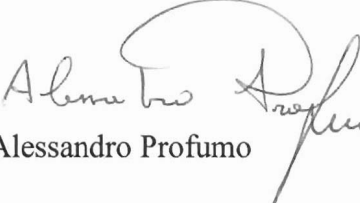
At a more macro level, in terms of financial stability a European Financial Stability Forum should be created to examine the major financial vulnerabilities it identifies and communicates to the Council of Economic and Monetary Affairs.

Priority should be given to achieving rapid convergence to a single internationally accepted set of high quality accounting standards, accounting guidance, auditing practices and rules on provisioning.

Achieving a degree of consistency, and where possible even convergence at the highest possible level, preferably global, will be a constant challenge to achieve, but it is in the interests of all to find consistent approaches to supervising financial groups operating in a multitude of jurisdictions.

I hope that these considerations will aid you and the High Level Group in formulating its recommendations to the European Commission's President Barroso, and we stand ready to respond to any queries you may have.

Yours sincerely,



Alessandro Profumo

**EBF CONTRIBUTION TO THE “DE LAROSIÈRE HIGH
LEVEL EXPERT GROUP ON EU FINANCIAL
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SUMMARY OF EBF CONSIDERATIONS

- **The review of the current prudential supervisory architecture should take as a starting point the ultimate objective of prudential supervision within the EU, which should be to achieve a pan-European financial supervisory framework to support a single financial market.**
- **In any future pan-European framework the prudential supervision of each institution should be consistent across countries and proportionate to the degree of systemic risk.**
- **Colleges of supervisors can reduce regulatory duplication and inconsistency, improve bilateral dialogue between regulators, increase levels of trust, and enhance the cooperation of supervisors. Colleges have already been implemented within the EU. This is the appropriate structure on which to enhance the supervision of large complex financial institutions. The college should normally act on the basis of a consensus among its member supervisors. In cases where consensus cannot be reached among the members of a college, the home supervisor should have the final say¹.**
- **Colleges would be supported as required by better-resourced CEBS, CEIOPS and CESR at the micro level.**
- **A European Financial Stability Forum (EFSF) should be created to examine the major financial vulnerabilities that it identifies and communicates to ECOFIN.**
- **Oversight and cooperation should address not only regulated institutions but also non-regulated institutions, markets, market infrastructures and other systems that are perceived as systemically relevant in the respective jurisdictions.**
- **Priority should be given to achieving rapid convergence to a single internationally accepted set of high quality accounting standards, accounting guidance, auditing practices and rules on provisioning.**
- **The introduction of a leverage ratio is undesirable.**
- **The definition of own funds should be fully harmonised across the EU and built under the framework to be issued by the Basel Committee on Banking Supervision.**
- **Stress testing on individual portfolios and of adverse systemic events are critical risk management tools.**
- **A common reporting language and a common reporting framework in the area of liquidity risk should be developed as a matter of priority within the EU and on a global level.**
- **Besides a single common reporting framework, a common process and IT language for reporting would need to be made available to banks.**

¹ The Austrian, Luxembourg and Polish banking associations do not share this EBF view.

- **Market participants should decide on and develop best practices to enhance Pillar 3 disclosures. Regulators should support the industry in developing a range of practices.**
- **To achieve a level playing field in Europe it is essential to move as quickly as possible towards harmonising further some elements of deposit guarantee schemes across the EU.**

DELIVERING EU SUPERVISORY CONVERGENCE AND EFFECTIVE MACRO-PRUDENTIAL OVERSIGHT ACROSS ALL FINANCIAL SECTORS

1. FINANCIAL SUPERVISION

1. The financial system of the European Union (EU) is a key player in global financial relations. Accordingly, it should take a leading role in achieving and maintaining financial stability. The overarching goals and objectives of financial supervision should be the following:
 - The global financial system must be efficiently supervised in a coordinated and consistent way across jurisdictions in order to remain sound and stable and thus support productivity growth and economic development.
 - The establishment of the European single financial market is one of the major goals of the European Union and calls for a single, equitable regulatory framework.
 - There is a major need for a uniform framework for financial supervision (including rules, supervisory practices and approaches that are applied consistently to all supervised entities) and in particular to the oversight of major cross-border groups.
 - The prevention of regulatory arbitrage, at both European and global levels, should also be at the heart of financial supervisory practices.
 - Large complex private sector financial institutions operate internationally and are organised accordingly. Only consolidated supervision can monitor their activities effectively; the current system based on national approaches and legal entities (“solo” supervision) is generally outdated. It does not reflect cross-border banking groups’ increasingly integrated and centralised operations, including their risk management. Instead, supervisory decisions at the consolidated level should be informed by local considerations and, in turn, the local level needs to be coherent with the consolidated level.

Prudential supervision of institutions

2. The review of the current prudential supervisory architecture should take as a starting point the ultimate objective of prudential supervision within the EU, which should be to achieve a pan-European financial supervisory framework to support a single financial market.
3. A number of pragmatic intermediate steps will need to be taken to achieve these long-term objectives. A first step would be to continue to enhance the existing EU supervisory structures.

Colleges of supervisors have already been implemented within the EU. This is the appropriate structure on which to enhance the supervision of large complex financial institutions. The college should normally act on the basis of a consensus among its member supervisors. In cases where consensus cannot be reached among the members of a college, the home supervisor should have the final say².

² The Austrian, Luxembourg and Polish banking associations do not share this EBF view.

National supervisors which take part in colleges of supervisors should act under a European mandate when supervising banking groups.

The Committee of European Banking Supervisors (CEBS) and the Committee of European Insurance and Occupational Pensions (CEIOPS) should be strengthened to bring consistency in the implementation of banking regulation and insurance regulation respectively, much needed convergence in supervisory practices across colleges, and close monitoring of level-playing-field issues.

CEBS and CEIOPS would need to be better empowered and resourced than at present with more permanent and seconded staff available to fulfil their tasks and ensure consistent prudential standards across sectors.

CEBS and CEIOPS would, moreover, be responsible for identifying emerging risks detected through their ongoing work and the sharing of their observations with the European Financial Stability Forum (see below) in order to contribute to the macro financial stability objective.

4. **In any future pan-European framework the prudential supervision of each institution should be consistent across countries and proportionate to the degree of systemic risk.**

Oversight of financial market infrastructures/systems

5. The oversight of financial market infrastructures (including clearing and settlement systems, information technology, and communication systems) implies identifying those infrastructures that are important from a systemic point of view. Because of the systemic importance of these infrastructures, their oversight needs to be integrated with the prudential supervision of financial institutions.

The European Financial Stability Forum (see below, paragraph 8) should identify precisely which infrastructures are significant from a systemic point of view.

Oversight of conduct of business

6. While prudential oversight within the EU needs to be integrated as quickly as is politically feasible, **it would be acceptable if a common EU approach to the development and enforcement of conduct-of-business rules progressed at a less ambitious pace.** The different nature of conduct-of-business supervision (investor and consumer protection) implies a different approach to regulation, much more oriented to the particular characteristics of national markets and cultures. The Committee of European Securities Regulators (CESR) should nonetheless also be better empowered and resourced to fulfil its tasks.

2. FINANCIAL STABILITY OVERSIGHT

European cooperation in financial stability oversight

7. Since a basic objective of the European Union is to achieve a single market for financial services, **it is crucial that consistent standards are applied throughout the EU**. Against this backdrop, there is clearly a legitimate role for the EU in monitoring financial stability and managing financial crises.

One lesson to be learned from the present financial crisis is that, when building a new EU financial supervisory framework, the primary focus should be on maintaining financial stability. The current crisis has been managed by the various governments, with only limited intergovernmental cooperation. The challenges created by this situation have clearly demonstrated the need for an appropriate EU structure to address financial stability issues. Therefore, **cooperation among financial authorities throughout the EU should be organised in such a way that supervisory authorities coordinate effectively to maintain financial stability across the EU³**.

8. There is a need for a high-level, independent body that would be responsible for providing early warnings of financial vulnerabilities, for preventing systemic crises, and for making recommendations on issues pertaining to macro-financial stability in an integrated way.

A European Financial Stability Table (FST) currently exists. It is a specific configuration of the Economic and Financial Committee (EFC) that meets twice a year to discuss financial stability issues. This Group includes the EFC members plus the Banking Supervision Committee of the European System of Central Banks and the three Level 3 Committees (CEBS, CEIOPS and CESR). Therefore, the FST brings together the broadest group of actors in matters of financial stability (prudential, monetary and fiscal authorities). It is said to be the most likely forum for agreement on any form of policy coordination. Irrespective of the future supervisory architecture in Europe, this body would now need to be institutionalised and upgraded by transforming it into **a European Financial Stability Forum (EFSF)**.

The EFSF would provide a body where senior representatives of all relevant authorities – i.e. central banks, the Level 3 supervisory committees (CEBS, CEIOPS & CESR) and senior officials of ministries of finance - would be assembled. Other bodies (such as the European Commission and the Economic and Monetary Affairs Committee of the European Parliament) might be given observer status. It would provide advice by means of concrete recommendations directly to ECOFIN, which would remain the decision-making body.

The EFSF would be politically independent and would examine the major financial vulnerabilities that it identifies. It would be supported by better-resourced CEBS, CEIOPS and CESR at the micro level, which would provide specific inputs to the EFSF as required.

9. The main mission of the EFSF would be to identify and examine the implications of EU-wide and global macro-economic and financial developments for financial stability within the EU. It would meet regularly to discuss key financial vulnerabilities in the EU in a global context, as well as possible responses.

³ The Council of 15 and 16 October 2008 decided to establish an informal warning, information-exchange and evaluation mechanism (the financial crisis cell) to enable speedy and effective action to be taken in a crisis situation.

It would have a mandate for integrated oversight of the EU financial system, i.e. to make recommendations on the oversight of institutions that provide financial services, financial markets, and market infrastructures. It would also be responsible for assessing the impact of financial innovations on financial systems' stability.

The EFSF would build a common EU view on the key vulnerabilities in the system and advise the ECOFIN on the major risks to financial stability. It would then be the responsibility of competent national authorities to take the appropriate mitigation actions.

The EFSF would also include in its analyses:

- (i) the implications of the macro-economic conjuncture for financial stability;
- (ii) institutional and structural developments and innovations in the financial system;
- (iii) the impact of regulation;
- (iv) the behaviour of financial markets; and
- (v) cross-border financial activities, inter-connectivity, and other effects.

10. It would be particularly important for the EFSF to have responsibility for mitigating regulatory arbitrage.

Currently, gaps in the scope of the regulatory system have provided incentives for regulatory arbitrage. This activity has contributed to the current financial crisis and, if undeterred, is likely to provoke new crises. Some of the innovations in the financial system in recent years had the primary objective of avoiding regulatory requirements. This means that regulatory gaps across market segments, institutions or financial jurisdictions should be brought under appropriate prudential scrutiny if they are of systemic importance across the EU.

11. Since the EFSF would be charged with taking a “holistic” view of financial stability, it would not only be looking at regulated institutions but also at non-regulated institutions, markets, market infrastructures and other systems which it determined to be systemically relevant (including IT and telecommunication systems that are important for financial system business continuity).

Financial institutions that are important from a systemic point of view - either individually or as a market segment – but have not been made subject to prudential supervision, should be required to report relevant data to the appropriate regulatory authorities.

Early warning mechanisms and cross-border crisis management

12. Within an integrated EU framework, the following principles should serve as guidance:

- Early warning signals would need to come from financial supervisors and be directed to the European Financial Stability Forum.
- Central banks – and Finance Ministers, if need be - would need to be closely involved when coordinating actions to be taken to prevent and/or manage cross-border crises.

13. To move forward in this area, progress is necessary on the following:

- Achieving consistency in the criteria for invoking standing liquidity facilities of central banks.
- Developing common early intervention mechanisms across the EU.
- Deposit insurance and applicable intervention mechanisms.
- Undertaking timely and orderly dismantling of the temporary facilities and state guarantees that governments have provided to banks. These mechanisms have created moral hazard as well as competitive distortions, which disadvantage, in particular, those institutions that have been relatively well run.

14. In addition, it will be important to enhance both crisis prevention and crisis management to ensure successful outcomes through coordination among central banks and between central banks and supervisors.

Building a common approach to these processes and protocols across EU Member States would strongly increase the likelihood of successful crisis prevention and management without reaching the stage of fiscal burden sharing. At the very least, this strengthening would reduce the impact of this thorny issue in the exceptional case(s) where it was seen as necessary. In such cases, public cost would be shared according to the Common Principles elaborated in the Memorandum of Understanding on cross-border financial stability of 1 June 2008.

3. THIRD COUNTRIES

15. An integrated global financial system requires international consistency of financial standards and supervision in order to mitigate regulatory arbitrage and vulnerabilities created by competitive distortions across jurisdictions.

As advocated for at the European level, a holistic view of financial stability should also be taken at the global level. **Oversight and cooperation should address not only regulated institutions but also non-regulated institutions, markets, market infrastructures and other systems that are perceived as systemically relevant in the respective jurisdictions. Regulatory arbitrage that has been organised on a global level, in off-shore centres in particular, should also be addressed.**

16. The European Financial Stability Forum (see paragraph 8 above) should be responsible for providing the EU's input into the work of the G20, the International Monetary Fund and the Financial Stability Forum.
17. Because of the worldwide integration of capital markets and the activities of banks, achieving better cooperation among supervisors at a global level is essential.

It would be beneficial to global cooperation if a compatible structure of financial supervision existed across the major financial centres, as this would facilitate identifying which bodies are in charge of the four major elements of the financial architecture (micro-prudential supervision, market conduct oversight, financial stability and crisis management). This would make it easier to organise a continuing dialogue at the global level

among regulators and financial supervisors. It would also be helpful to make a clear distinction between regulatory and supervisory activities.

It would be essential for all countries involved to recognise that this needs to be addressed as a matter of urgency to avoid situations in which one major jurisdiction or another would start organising itself internally without paying due regard to the need for international coordination.

18. Efforts to harmonise those rules, standards and principles that are particularly important to safeguard the soundness of financial institutions and financial stability should be speeded up.

Priority should be given to achieving rapid convergence to a single internationally accepted set of high quality accounting standards, accounting guidance, auditing practices and rules on provisioning.

19. The cooperation in micro prudential supervision should be organised through the continuous work of supervisory colleges, which are specific for each individual financial group, depending on the scope of its activities and its structure. They should include the major supervisors of banking groups.

Colleges of supervisors can reduce regulatory duplication and inconsistency, improve bilateral dialogue between regulators, increase levels of trust, and enhance the cooperation of supervisors. The objective of a college should be to:

- facilitate the exchange of information, views and assessments among supervisors in order to allow for more efficient and effective consolidated and solo supervision, and timely action;
- enable supervisors to develop a common understanding of the risk profile of the group as the starting point for risk-based supervision at both group and solo levels;
- achieve coordination of supervisory review and risk assessment, establishing supervisory plans, arranging the division of tasks and joint on-site visits, thus avoiding duplication of work and reducing the regulatory burden; and
- take joint decisions.

The nature of the “global” colleges is different from those that have been set up in the EU, because of the differences in the legal framework. While it may therefore be unavoidable at this stage to have two separate college structures – one to address global considerations and the other under the EU legal framework – this clearly is suboptimal. Ultimately, there should be only one single college. To avoid inefficiencies in the meantime, cooperation between both colleges must be ensured by means of joint meetings.

4. UPGRADING BASEL II

20. In light of recent experience, the Basel Committee on banking supervision has published for comment proposals to strengthen the Basel II framework. When implementing new elements of the Basel II framework, **sufficient time should be granted to the industry to address new requirements.**

Quality and Quantity of Capital

21. Own Funds requirements have a substantial impact on the competitive position of banks. **It is, therefore, essential that the definition of the Own Funds concept be fully harmonised across the EU and built under the framework to be issued by the Basel Committee on Banking Supervision.**
22. We note that the focus of regulators in recent recapitalisation proposals has been to require firms to hold levels of core Tier 1 capital significantly in excess of the minima prescribed in the Capital Requirements Directive (CRD) and the Basel II framework. This has inevitably encouraged banks to hold a buffer over this core Tier 1 capital requirement, which has knock-on effects on the market's (and rating agencies') expectations about core Tier 1 capital levels in the future. **The current harmonisation of capital definitions being proposed in the CRD is welcome. Regulators should be prepared to widen their view of the acceptable constituents of regulatory capital to include hybrid Tier 1, as well as Tier 2 and Tier 3 capital.**
23. As regards the treatment of goodwill, even if a deduction of goodwill from net worth⁴ cannot be restated, **an amortisation of part of the goodwill (the most volatile component) could be examined and the remaining part, which would become "core" goodwill, could also be considered in the regulatory framework.**
24. It is clear from the current crisis that elements such as a firm's business model and its level of diversification can become determining factors in times of stress. Imposing (core) capital ratios applicable to all firms irrespective of the nature of their business may well prove ineffective in stress situations.
25. Whilst in place in the US, the leverage ratio has not resulted in a safety cushion for US-based banks during the crisis. The gross leverage ratio employed in the US did not prevent losses on sub-prime assets or the liquidity strains arising from their sponsoring of SIVs and conduits.

Imposing a maximum leverage ratio on each regulated institution, along the lines of the current definition in use in the US, would lead to insurmountable issues for EU-based banks, even those less impacted by the crisis, and would by no means take into account risks incurred in the course of business.

Implementing a leverage ratio would be a step back from the risk sensitive capital framework that Basel II represents. Given that losses incurred in the crisis stem mostly from liquidity and accounting issues, it may prove more effective to resolve these.

We therefore believe that the introduction of a leverage ratio is undesirable.

Stress Testing & Contingency Planning

26. Stress-testing is a critical modelling and risk-management technique that banks use to check estimates and parameters, but it remains mainly an instrument of a bank's self-assessment, to be used with judgment and accompanied with qualitative evidence, rather than a validation

⁴ The deduction of goodwill from the net worth, which is the approach followed by prudential supervision, was, before the Fourth Council Directive, the common accounting principle followed by the industry.

procedure as such. The governance and qualitative aspects of stress testing are as important as the quantitative element.

Stress tests are complementary to day-to-day models (such as rating or VaR models) and are intended to identify combinations of risk factors that could lead to large losses in the portfolios being assessed. **The tests should be performed on individual portfolios and thus by individual banks. Various scenarios may need to be tested depending on the specific sub-portfolio.**

Stress testing of adverse systemic events is also desirable. For systemic stress tests, the authorities should provide the scenario by choosing the assumptions for such tests and should see the results of the individual firms' stress tests of these assumptions, given their differing business models.

27. Against this background, we do not believe that the details of non-systemic stress test scenarios should be laid down by supervisors because such stress tests should take into account differences in bank portfolio structures. Stress testing and contingency planning should be addressed as integral components of a bank's Internal Capital Adequacy Assessment Process (ICAAP). Therefore, the capital "cushion" should be decided by the bank itself and not imposed via standardised regulatory rules. The introduction of rules and regulations in this area could lead to a "tick-box" approach to stress testing. **In the case of systemic stress testing for broader financial stability purposes, there is an argument for macro-economic and macro-financial parameters to be provided by the relevant authorities so that they are used uniformly across the sector.**

It is important to ensure that the results of stress tests receive adequate management attention and are fed into the bank's risk management process (see also paragraph 47 et al.). Stringent internal procedures and standards are required for this purpose (e.g. stress test reporting, stress test limits, contingency planning). **Stress test results should be integrated into a credible contingency plan. The measures that will be triggered by a threat identified during a stress test should be clearly specified. If there are signs that certain economic scenarios are materialising and that action is called for, suitable countermeasures should be taken.**

The integration of stress testing into the risk management process in banks is an evolving area, and it is essential that banks continue to have room to innovate and improve their stress testing processes.

Pro-cyclicality and Dynamic Provisioning

28. The Financial Stability Forum has directed the Basel Committee on Banking Supervision to put a data-collection framework in place to monitor Basel II's impact on the level and cyclicality of capital requirements. We support this international approach, and we propose to expand it to counter the pro-cyclicality effects on Value at Risk (VaR) and credit risk under the internal ratings-based approach.

The possible pro-cyclicality of the Basel II framework has led to calls for further consideration of a new regime of dynamic provisioning which would see banks making provisions for losses starting at the point when loans were originated. The concept is that

an increase in the stock of provisions during periods when losses are unusually low would help protect banks against periods when losses are unusually high.

The industry accepts that there must be sufficient buffers to cover the build up of cyclical pressures in the system, so that their impact on the wider economy is minimised and the need to raise capital in downturns is reduced. **Dynamic provisioning can help offset the effect of pro-cyclicality, and help the firm manage through a crisis.**

However, dynamic provisioning at present takes many forms, among others due to local specificities. Rather than imposing a fixed format, supervisory bodies should assess, and appropriately reward, dynamic provisioning established as the firm sees fit.

Moreover, measures that off-set pro-cyclicality should be developed on a global basis and be presented in such a way that any reduction in regulatory capital ratios is not viewed negatively.

- 29. The Basel Committee should intensify its co-ordination efforts with accounting standard setters, and jointly undertake an impact analysis on the effectiveness of capital adequacy requirements in the context of changing accounting standards.** Efforts to offset the volatility effects of accounting and capital regulations should not be assessed or decided in an isolated manner.

Regulators should carefully take into account the fiscal impact of the application of dynamic provisioning. Where dynamic provisioning is applied, the fiscal treatment must be comparable across jurisdictions.

Pillar 2

- 30.** Economic capital (EC) models seem to have lost some of their credibility in the current crisis. However, supervisory bodies should take into account that techniques will improve and will converge progressively, provided that banks are encouraged to keep on investing in them. **The merits of the EC models should not be undervalued, even if they must not be presented as the magic answer to all questions. Be that as it may, further work on EC models will continue to enhance firms' risk management capabilities.**

A firm's Internal Capital Adequacy Assessment Process (ICAAP) should, under all circumstances including those of today, remain an internal process. **Attempts to regulate the way firms model their risks or aggregate the risk types should be avoided: They would even disincentivise further developments and improvements to firms' portfolio models.**

In the current crisis it has become abundantly clear that the firms that have performed better than their peers tend to have both more diversified business lines and more widely diversified balance sheets and income statements. In other words, **the better performing firms are those that have well-diversified profiles in terms of their portfolios, funding, and business plans.**

The Pillar 2 exercise should be based on an assessment of the consolidated position of the financial institution that is under review, and **the process should be coherent for all subsidiaries and branches.**

Asset Securitisation

31. Policy action should ensure that the appropriate checks and balances operate along the securitisation chain – i.e. sound origination, sound structuring, sound due diligence, sound rating analysis, and sound investor due diligence.
32. Complex securitisations contributed to the current circumstances. However, securitisations are usually of originated assets (first level securitisation or “plain vanilla”) and are invaluable in spreading risk and providing additional liquidity in such important areas as mortgage provision, credit cards and student loans. It is the effective closure of the securitisation market that is one of the high priority issues of the credit crunch and its consequences. **A range of industry issues are in hand to address the perceived inadequacies of the originate-to-distribute model, including better transparency and a more appropriate risk matrix. Many of these initiatives are now finalised and implemented in the Member States, but will require more time to bed down.**

5. PRUDENT LIQUIDITY MANAGEMENT

33. A significant aspect of mitigating systemic risk is the management of liquidity, especially in times of global macro-economic shocks and contagion. An obstacle for global liquidity risk management is that national liquidity standards are not harmonised across countries. As banks become more internationally active, the rationale behind domestically focussed liquidity requirements may need to be reconsidered, and weighed against the fact that the viability of global banks depends on timely flows of liquidity among jurisdictions.

Well before the events 2007-2008, the EBF had suggested to banking supervisors and central banks that they should review supervisory practices in the area of liquidity risk management, as these had become obsolete. The current financial crisis has made it even more evident that liquidity risk management and supervision practices need to be reconsidered.

34. The EBF supports any move that would be made as **a matter of priority within the EU, and on a global level, to develop a common reporting language and a common reporting framework in the area of liquidity risk.** Introducing common templates in this area would serve the interest of the banking supervisory community, as these are likely to facilitate a “common language of liquidity” as well as enabling supervisors to identify potential sources of liquidity vulnerabilities. It would also serve the interests of the many banks that are operating in multiple jurisdictions and that are currently faced with a variety of liquidity reporting practices.
35. **Developing a common reporting framework in this area would be a prerequisite to developing a common set of metrics that the supervisory community could use as benchmarks to assess liquidity risk.** However, such a common set of metrics should not aim at setting a common absolute ratio, since assessing an acceptable level of exposure to liquidity risk requires taking into account banks’ risk profiles (which may depend on the macro-economic environment in which banks operate as well as their business models, etc).

Instead supervisors should allow banks that have set up an adequate internal framework to measure liquidity risk and to apply the common set of metrics on a comply-or-explain basis.

For banks that have not set up such a framework, supervisors may envisage elaborating a standardised, quantitative ratio, which would be imposed as a *de minimis* standard. We would stress that the metrics developed by the regulator will not necessarily be an exhaustive list of metrics used by the industry to measure liquidity.

36. Monetary authorities – within the EU as well as on a world-wide level - should discuss among themselves ways to significantly improve their current practices and, more particularly, set up arrangements aimed at reducing overall liquidity risk. The current lack of consistency in collateral eligibility and transferability of collateral between monetary authorities (central banks) in different countries inhibits the free cross-border flow of liquidity within international banking groups, thus increasing systemic risk and adding to costs through the consequential need to maintain separate, trapped pools of liquidity in several jurisdictions. Their main focus should be on improving the means that banks and other financial institutions have at their disposal to avoid liquidity crisis situations.

In this context, it would be essential for central banks to agree among themselves, as a basic principle, that each of them should be prepared to provide liquidity (subject to appropriate haircuts) if “good” collateral is available, irrespective of the location of the collateral. This means that if no sufficient collateral were available at the host country’s central bank it should accept to provide liquidity to the bank on the basis of the collateral that the latter had made available to a central bank located in another country.

At the same time, work should be undertaken to achieve a common definition of what “good” collateral means, and widen the range of marketable high-quality assets that each central bank is prepared to accept as “good” collateral. Moreover, efforts should be made to allow for “good” collateral denominated in major foreign currencies to be more readily accepted than it is today.

37. Pending the outcome of these efforts to harmonise rules and practices, regulators, by way of colleges, should improve coordination in this field, matching the needs of the firms they supervise to regulatory practice.

The immediate focus of such colleges should be the elimination of practices that hinder intra-group funding and result in unnecessary ‘trapped’ pools of liquidity. However, firms recognise the concerns of individual countries and their need to protect depositors and investors, particularly when parts of their retail banking industry are operated as subsidiaries or branches of a financial institution headquartered elsewhere.

6. STRENGTHENING OF THE INFRASTRUCTURES

38. Market infrastructures do not benefit from the EU passport or mutual recognition. This impedes the interoperability between exchanges, central counterparties and central securities depositaries that is required to enhance counterparty risk management.

A stronger partnership between the public and private sectors is needed to improve securities and foreign exchange settlement and payment systems in order to strengthen competition in the provision of infrastructure services.

7. SETTLEMENT OF CREDIT DERIVATIVES

39. The vast majority of derivative contracts have traditionally been settled bilaterally on over-the-counter (OTC) markets. In the wake of the Lehman collapse and the general market instability at that time, supervisors have increasingly called for greater regulatory oversight of the OTC derivatives markets. **Public policy officials generally agree that the most effective way to increase transparency and foster greater stability in the settlement process is to require the vast majority of derivatives contracts to be cleared through central infrastructures.**

The concerns of European policy makers to have oversight over single or multiple central clearing of credit derivative markets are legitimate, but they need to be balanced by actions to assure the efficiency and reliability of a single or multiple central counterparties (CCP).

Since the derivatives market is highly concentrated in a small number of major global financial centres, increased cooperation and coordination amongst European supervisors, and with their global counterparts from major capital markets, will be indispensable to enhancing the structural soundness of central clearing without fragmentation of risk.

The allocation of regulatory capital to these CCPs ought to be recognised in the continuous pursuit of increasingly efficient markets. The CCPs that will eventually be set up in Europe to clear Credit Default Swaps (CDS) should be put on a globally level playing field concerning their capital treatment.

To achieve this aim, a number of technical considerations and implementing measures need to be resolved.

8. TRANSPARENCY

Structured credit

40. The European financial services industry has issued good practice guidelines which are aimed at promoting a minimum standardised disclosure regime. These guidelines take into account views held by market participants in Europe on their information needs in this respect.

The forthcoming review which the Basel Committee is undertaking of its recommendations on Pillar 3 disclosures in this area should build on the industry's guidelines.

Forthcoming Review of Pillar 3 Requirements

41. Pillar 3 disclosures should focus on the information needs that market participants consider most relevant to the market conditions at the time of disclosure in order to ensure that they remain material, responsive to real market needs, and relevant to economic conditions. The best way to achieve this would be that - as recommended by the FSF in its April 2008 Report - "going forward investors, financial industry representatives and auditors should work together" to make this happen. This means that **market participants should decide on and**

develop best practices to enhance transparency. Regulators should support the industry in developing a range of practices.

The initial objective of Pillar 3 disclosures was that they would primarily provide a window on Pillar 1, i.e. to allow market participants to assess the risk-management thinking at each firm. Against this backdrop, Pillar 3 is a distinctive type of disclosure that requires a different analysis from the typical sort of financial disclosures and may also need to be presented differently for the market's understanding. The transparency that Pillar 3 was supposed to bring would be decreased if the forthcoming review of Pillar 3 would be used to add a range of additional disclosures that are not intended to allow market participants to assess essential information on a firm's capital, risk exposures and risk assessment processes.

42. **Of equal importance is the need to avoid duplication in the Pillar 3 discussion of disclosures already covered by accounting or securities requirements.** Such duplication would only contribute to the widely recognised problem that excessively voluminous disclosure can contribute to opacity in the market as well as being burdensome to firms.
43. There are some differences between the current Basel Pillar 3 disclosure requirements and those contained in the CRD. **The forthcoming review of the Pillar 3 requirements that the Basel Committee is preparing, and their transposition into European legislation, should be used as an opportunity to align both sets of requirements.**

COREP

44. The EBF has acknowledged with satisfaction the request which ECOFIN has made to CEBS to “move towards *EU-wide reporting formats so as to have a single set of data requirements and reporting dates*”.

Reporting: need for a common language

45. **Besides a single common reporting framework, a common process and IT language for reporting would need to be made available to banks.** If not, the benefits that a common IT language for the reporting framework would bring might be seriously hampered, since it would oblige institutions to “translate” the same reporting into different IT languages (XBRL, XML, Edifact, SDMX, etc.) and use different ways of validating and certifying the reported figures.

9. CORPORATE GOVERNANCE

Compensation

46. Through regulatory tools such as Pillar 2, supervisors – without being prescriptive -- should encourage banks to ensure that they understand the potential for inappropriate incentive structures in their remuneration policies. Remuneration policies are inseparable from risk management and should appropriately reflect the risk appetite of the financial entity. **Framed in this way, it can also be included as part of the holistic regulation of the entity and play a role in the regulatory capital assessment process.**

Risk Management Dimension

47. The Basel II framework has built in many references to responsibilities in relation to the Board's responsibilities for governance and oversight of senior management. This applies, in particular under Pillar 2; e.g. Principle 1: Banks should have a process for assessing their overall capital adequacy in relation to their risk profile and a strategy for maintaining their capital levels. It indicates that *A sound risk management process is the foundation for an effective assessment of the adequacy of a bank's capital position and that the bank's board of directors has responsibility for setting the bank's tolerance for risks.*

The CRD carries this through, e.g. in Annex V on "Criteria concerning the Organisation and Treatment of Risk".

48. These principles have been translated into operational practice in banks generally, and through regulatory and supervisory developments. ICAAP submissions require banks to outline how they undertake such principles in practice. These submissions describe the ways in which the Board of Directors is the ultimate owner of risk – typically via the Board's Audit and/or Risk Committees.
49. **Since these principles and rules already exist, the main emphasis should be on them more forcefully and focusing more on specific amendments**, such as ensuring that the Head of Risk is a member of the Executive Board or Committee and reports to the CEO, placing the Risk Committee under the oversight of a Board member, ensuring that non-executive directors on Audit and Risk Committees have appropriate skills, and providing a suitable blend of skills on Risk and Audit Committees.

10. International Financial Reporting Standards (IFRS)

50. Enhancing the consistency of financial information is key to restoring investors' confidence.

The application of a single high-quality set of accounting principles in all jurisdictions on a world-wide basis would enhance the comparability of financial statements that is essential at global the level. **We therefore strongly support rapid convergence of IFRS and US GAAP to remove current inconsistencies. A single set of accounting rules is essential to achieve an international level playing field, covering both accounting practices and prudential regulation, so that conflicting incentives can be avoided.**

51. IFRS must be of high quality, as it is vital for the functioning of capital markets that investors have confidence in the quality of IFRS financial statements. In order to meet this requirement, it is crucial that financial statements reflect the economic substance of the transactions and provide a faithful representation of business models. **We therefore support the European Commission's ongoing dialogue with the IASB on such matters as the fair value option, impairment of financial instruments classified as "available for sale" (AFS) and embedded derivatives as well as on loan provisioning.**

52. **IFRS must not be limited to an investor-oriented approach, as a too-narrow focus can create bias, IFRS should serve multi-tier purposes, including: accounting, financial stability, supervisory and statistical purposes, in the framework of an integrated reporting system, and should meet the needs of users, preparers and regulators.**
53. The corollary to this point, recognised in the 15 November 2008 Communiqué of the G20 leaders, is that the governance and membership of the IASB must be reviewed as a key priority. This is particularly important in light of recent difficult negotiations between the European Commission and the IASB. **We would support the measures brought forward by the IASB's Trustees in the summer of 2008 to enhance oversight of the IASB.** These proposed measures include the creation of a new monitoring body to oversee the work of the Board of Trustees that oversees the IASB and the enlargement of the IASB to ensure that it properly reflects the IASB's growing constituency base. We agree that this is a short term priority.
54. Sole reliance on *full* fair value measurement model of financial instruments should be opposed, since it does not reflect properly the way the business is managed and it is oriented only to provide information to investors overlooking the needs of other users. In addition, the crisis has demonstrated that the full fair value model does not adequately capture situations where deep and liquid markets are receding or non-existent.

Therefore, the mixed model of valuation is the only model that is able to take into account the complexity of the banking business and provide an adequate valuation system for each of the relevant activities of a bank (generally speaking: fair value for trading, amortised cost for long-term activities).

55. **To create a level playing field among market participants across Europe, all EU Member States should allow non-listed companies within group structures to use IFRS for the preparation of their individual statutory accounts.** At present, the current system requires some groups to use a double set of accounting standards. It therefore results in reconciliation issues and a heavy implementation burden, which is further exacerbated by potential inconsistencies between the institution's internal information systems and its financial reporting.

The expanded use of IFRS in solo (individual) accounts would represent a significant incentive to design an integrated reporting system that could simultaneously serve accounting, supervisory and statistical needs.

A first step toward the establishment of such an integrated system should be to review current IFRS with the objective to put in place a set of accounting definitions which not only serve the needs of present and future shareholders, but may have a broader multidisciplinary scope of application, encompassing public interests, creditors, etc.

56. **For those Member States that apply Financial Reporting (FINREP), it could ideally be transformed into a true and cost-efficient starting point for all the reporting processes affecting the banking business (accounting, supervisory and statistical).**

11. DEPOSIT GUARANTEE SCHEMES

57. The EBF welcomes the recently revised Directive on Deposit Guarantee Schemes and looks forward to the outcome of the Commission's further work on the review of deposit guarantee schemes. The EBF has also begun to examine various elements of deposit guarantee schemes but is at this stage not in the position to provide its definitive views.
58. **The review of deposit guarantee schemes should be undertaken from the perspective of the integration of Europe's financial markets and the protection of the single market.**
59. The constitutive elements of the European safety net for financial stability can hardly be addressed independently from one another. Thus **deposit guarantee schemes must be closely linked to properly functioning prudential supervision**. When harmonising further the playing field for deposit guarantee schemes in the EU, consideration should therefore be given to progress in the integration of supervisory regimes and further convergence of the instruments for crisis management and resolution.
60. **To achieve a level playing field in Europe it is essential to move as quickly as possible towards harmonising further some elements of deposit guarantee schemes across the EU.** This implies, as regards the coverage level, abolishing Institutional Protections Schemes⁵ and further 'voluntary deposit protection schemes'⁶ which, in some EU Member States, provide additional coverage to a limited number of banks besides the regulatory coverage provided for in the EU Directive.

This means that all legal entities operating within a Member State should: (i) provide the same protection to all customers, and (ii) invoke a similar cost in terms of contributions to the deposit guarantee scheme. Only when there is more harmonisation of the scope of coverage (types of deposits covered and provisions for setting off customer accounts), coverage level, eligibility of depositors and procedures for pay-out, will customers have adequate confidence in the efficiency of deposit guarantee schemes.

⁵ As there exist in Austria and Germany.

⁶ As there exists in Germany.

ANNEX

The EBF wishes to offer the European Commission’s High Level Expert Group on Financial Supervision chaired by Jacques de Larosière its Considerations on “Strengthening European Financial Supervision and Stability Oversight and Reinforcing Cooperation between European Supervisors and their International Counterparts”.

The EBF Considerations have been developed under the guidance of the EBF own High Level Expert Group, chaired by Malcolm Knight, and adopted by the respective EBF technical committees and the EBF Executive Committee.

The EBF’s High Level Expert Group is composed of:

- Malcolm Knight, Vice-Chairman, Deutsche Bank Group,
- Davide Alfonsi, Head of Group Risk Management, Intesa Sanpaolo,
- Gonzalo Gil, Member of the Board, Banco Pastor
- Christian Lajoie, Basel coordinator, BNP-Paribas
- Sonja Lohse, Head of Group Compliance, Nordea Bank, (and Chair of the Financial Markets Committee of the EBF)
- Karl-Heinz Raschtuttis, Head Group Strategy & Controlling, Commerzbank
- Karl Snowden, Head of Public Policy HBOS Group, (and Chairman of the EU Strategy Committee of the British Bankers’ Association)
- Freddy van den Spiegel, Chief Economist Fortis Bank, (and Chairman of the Global Banking Issues Committee of the EBF)
- Karien van Gennip, Director of European and International Affairs ING Bank,
- Robert Wisniewski, Deputy Head of Credit Risk Management, PKO BP SA