



18 January 2005

## WORK PROGRAMME FOR 2005

### Executive summary

1. CEBS initiated several strands of work in 2004, in response to the great demand for convergence in banking supervisory practices and in relation to the finalisation of the proposed Capital Requirements Directive. The publication of the work programme will allow all interested parties to know in which areas progress is expected and within which time frame. This should also favour a better participation in consultation processes and an open dialogue with the industry and end-users of financial services. The work programme should also allow European institutions to form a view on the way in which the Lamfalussy framework is being operationally implemented in the banking sector and facilitate the accountability vis-à-vis the European Parliament, the European Council and the Commission.
2. CEBS has decided to divide its work programme under three main priority areas which can be described as (i) regulatory advice to the Commission (ii) convergence of supervisory practices; and (iii) co-operation and information exchange. Under each work area separate work streams are highlighted as high priority in 2005.
3. **Regulatory advice to the Commission** will encompass work on the possible obstacles to cross-border mergers in banking and, in a medium term perspective, on the definition of regulatory capital. Towards the end of 2005 CEBS will be expected to start working also on the framework for the supervision of liquidity risk. CEBS will also be asked to contribute to the issue of deposit insurance schemes. Topics arising from discussions at the Basel Committee of Banking Supervisors may also develop into additional fields of advice to the Commission.
4. **Convergence of supervisory practices** is an area in which CEBS is very active, in order to exploit the window of opportunity provided by the new framework for capital adequacy and the adoption of International Financial reporting Standards (IFRS). The input received in the consultation on the Supervisory Review Process is leading to further progress in this area. Particular attention will be devoted to the interaction between the Internal

Capital Adequacy Assessment Process (ICAAP), which is a responsibility of supervised institutions, and the Supervisory Review and Evaluation Process (SREP), which places certain obligations on the supervisory authorities and leads to the identification of prudential measures. CEBS is also developing with high priority guidelines on the validation of internal ratings based (IRB) systems and advanced measurement approaches (AMA). Work is being developed also on guidelines for recognition of External Credit Assessment Institutions (ECAIs). Financial reporting is another key priority in the areas of convergence: CEBS is developing an XML-based solution as a basis for a common reporting framework for the new solvency ratio, in a framework to be further extended to financial reporting in general. Supervisory disclosure is a crucial element in ensuring consistent implementation and application of the new framework for capital adequacy. In line with the proposed Capital Requirements Directive, CEBS is developing a framework for reporting on the implementation of the Directive itself, on the exercise of options and discretions and other relevant information in such a way to enable a meaningful comparison of approaches adopted in different Member States. The new International Financial Reporting Standards (IFRS) raise several issues from a supervisory perspective and constitute a very relevant strand of work for CEBS. Further to the development of guidelines on prudential filters, aimed at mitigating the effects of IFRS on regulatory capital, CEBS will continue working on the development of common IFRS compliant reporting formats and on supervisory guidance for the new framework.

5. ***Co-operation and information exchange*** covers as a priority the following work streams: home/host issues, crisis management and the exchange of confidential information. On home/host issues the goal is enhancing the two-ways flow of information between home and host authorities, clarifying the operational arrangements allowing the consolidated supervisor to fulfil its role and all involved authorities to adequately participate in the process in line with their legal responsibilities. On crisis management CEBS is working together with Banking Supervision Committee of the ESCB to enhance the convergence of supervisory practices and to develop effective operational network mechanisms and to organise simulation exercises. CEBS will consider further how to develop its framework for exchanging confidential information in order to ensure the pursuance of supervisory objectives in increasingly integrated markets.
6. Outside the priority areas the secretariat has identified a large number of work streams and projects that have been started and are being addressed in various expert groups.
7. A table providing a timeline for each project is attached to the work programme and will be constantly updated in CEBS' website. Any postponement will be highlighted in the table, explaining the reasons for it. This table is intended to disseminate information on the timing of the different projects and the relative consultation processes, so that interested parties

could prepare in advance. It would also play a role of internal governance for the Committee and the Secretariat, as it could be used to track progress in different areas and to identify possible bottlenecks.

## **Introduction**

1. In preparing this work programme a great deal of attention has been paid to those issues identified by panels of market participants, including the Expert Group on Banking established by the Commission within the process for defining priorities for the post-FSAP (Financial Services Action Plan) phase and the Financial Sector Roundtable. A discussion with CEBS Consultative Panel has been essential in identifying priority areas for work according to market participants and end-users.

## **CEBS Charter and main orientation**

2. According to its Charter CEBS has to fulfil three main tasks: (i) advising the Commission either at the Commission's request or on the Committee's own initiative, in particular for the preparation of draft implementing measures in the field of banking activities; (ii) contributing to a consistent implementation of EU directives and to the convergence of member States supervisory practices across the European Union; (iii) promoting supervisory co-operation, including through the exchange of information.
3. The main piece of Community legislation in the area of relevance for CEBS is being presently finalised, with the revision of the framework for capital adequacy of credit institutions and investment firms. As it appears from the preliminary feedback to the Commission's request for input on the post-FSAP phase, the focus of initiatives aimed at improving the functioning of the Single Market should now be more on implementation and enforcement than on the issuance of new legislation. Hence, it could be expected that – differently from the experience of the twin Committee of European Securities Regulators (CESR) in the first period of implementation of the Lamfalussy approach – CEBS will not receive an extensive demand for regulatory advice from the Commission in 2005. The main focus of CEBS work should therefore be on Level 3 work, i.e. on ensuring consistent implementation of Community legislation, convergence in supervisory practices and an effective process for supervisory co-operation in an increasingly integrated market for financial services.
4. As the new Capital Requirements Directive will change substantially the approach to supervision of banks and investment firms, it seems natural to consider this area as a key priority for Level 3 work at CEBS. In fact, every authority will have to substantially revise its methodologies for supervision; therefore, there will be a window of opportunity for moving to more common approaches and for the joint development of best practices. Furthermore, Basel II implies a move of supervision towards a process-oriented, risk-focused approach. As the internal processes for risk measurement and control at banking organisations are often defined in a homogeneous fashion for the whole group, irrespective of where the business is conducted, a co-ordination of supervisory approaches seems to be warranted to avoid

duplication of controls that might hamper the integration of financial markets in the EU. Increased consistency in prudential supervision across the EU may contribute to cross-border business and competition, thus favouring a more efficient allocation of financial resources and better conditions for consumer of financial services.

5. This focus on Basel II implies that CEBS will not be in a position to devote a great deal of attention to other areas, which could also be relevant for favouring an integrated, efficient and stable market in the EU. In particular, analyses of the progress of financial integration in the EU have shown that the integration of retail markets is progressing at a rather slow pace. This might be the result of differences in the conduct of business and consumer protection frameworks in Member States, of remaining inconsistencies in the legal basis for contracts and consumer redress procedures, as well as of discrepancies in tax treatment of financial instruments. CEBS does not envisage addressing these issues as its core area of competence.
6. Recent corporate scandals have also brought to light the need for more effective controls on conflicts of interest, the effectiveness of internal and external controls on companies' accounts, the possible use of off shore centres to conduct financial crimes. As mentioned below, CEBS will conduct some work on the internal governance of banks, even though mostly related to prudential aspects, and on off shore centres. However, the bulk of the work under way at the Community level, for all types of companies, is presently conducted within CESR. CEBS therefore does not intend to interpret its role, at least at this stage, as contributing to major progress in this area.

### **Factors behind the priority areas**

8. In defining its priorities CEBS should consider several factors that are affecting the call for intensified co-operation between banking supervisors at the EU level. These include:
  - market developments, in particular, developments in cross-border business, organisation of business lines and risk management functions at cross-border groups, financial innovation and business practices at EU banks, possible risks to financial stability;
  - the requirements of the proposed Capital Requirements Directive on the tasks of the consolidated supervisors in a cross-border context and supervisory disclosure
  - the demand coming from market participants and end users of financial services, in particular in terms of streamlining of the supervisory process and reduction of compliance costs for cross-border business;

- the requests from European institutions, including the call for enhanced exchanges of information between supervisors and effective supervision of cross-border groups and conglomerates, the need to review possible problems with off-shore centers, the demand to streamline reporting requirements and the request to co-operate with finance ministries to enhance the framework for crisis management.
9. Within such wide-ranging demands for CEBS work, priorities have also been defined with a view to focus efforts in those areas in which CEBS output is likely to have a real impact on the safe and prudent management of banks in the Single Market. Furthermore, priorities have been identified also with a view to ensure that tangible progress is delivered through time, with a balanced blend of projects that are likely to be finalised in the short term and others that will need more time to be completed (but are likely to have a larger impact on the smooth working of supervisory arrangements).
10. CEBS Consultative Panel highlighted as priority matters home-host issues (also with reference to Pillar 2, the supervisory review process), Pillar 2, the validation of Internal Ratings Based (IRB) systems and of Advanced Measurement Approaches (AMA) for operational risk and further elimination of unnecessary national discretions in the European Directives. Accounting was also mentioned as a relevant area of work, in view of the reform of international accounting standards and its interaction with prudential requirements. A representative of consumers of financial services suggested that great attention should also be devoted to the area of corporate governance.

### **Priority areas**

11. CEBS' work areas can be grouped under three headings: co-operation and information exchange; convergence of supervisory practices; and regulatory advice to the Commission and other externally driven work streams. Under each heading separate work streams are highlighted as high priority in 2005.

- **Regulatory advice to the Commission**

The Commission has indicated that CEBS will receive requests for advice on several new issues. These include: possible obstacles to cross-border mergers in banking, the definition of regulatory capital and the supervision of liquidity risk.

The work on cross-border mergers and acquisitions (M&As) relates to the commitment taken by the Commission with the ECOFIN Council to review the impact of supervisory rules embodied in Community legislation that could negatively impact M&A activity in the EU. It will encompass issues such as the criteria for assessing the suitability of the potential acquirer, the thresholds for supervisory reporting and the time limits for supervisory

feedback, the possible use of mutual recognition arrangements, transparency provisions and redress mechanisms.

The work on the definition of regulatory capital should be seen as a long term project and will envisage the definition of conceptual criteria for the definition of own funds and an up-to-date survey of own funds instruments recognised in Member States.

CEBS should also be aware of the upcoming review of the Deposit Insurance Directive and of discussions in Basel on trading book issues. On both topics, it may be necessary to provide supervisory advice to the Commission.

Liquidity issues will be developed over a long term horizon, starting in all likelihood in the last part of 2005. The work will build on the findings of projects under way at the Joint Forum and in the BSC and will aim at identifying possible ways to address the mismatch between increasingly centralised management of liquidity at cross-border groups and the remaining differences in the regulatory and supervisory approaches in Member States, in an area to which the home country principle has not yet been extended.

CEBS will be asked to contribute to the upcoming review of the Deposit Insurance Directive. It also needs to be aware of any additional issues which may arise from discussions in Basel such as the topics of trading book issues or risk buckets.

- **Convergence of supervisory practice**

- Supervisory review process

- CEBS has published a consultation paper on general principles for the Supervisory Review Process. Following the responses from the consultation exercise, these principles will be developed into guidelines. Particular attention will have to be devoted to the interaction between the Internal Capital Adequacy Assessment Process (ICAAP), which places certain obligations on the supervised institutions, and the Supervisory Review and Evaluation Process (SREP), which places certain obligations on the supervisory authorities and leads to the identification of prudential measures.  
*Deliverable: guidelines*

- National Discretions

- CEBS continues its work aiming at providing advice on possible ways to converge in supervisory practices with regard to the interpretation and implementation of the CRD. This will help to narrow in due course the extent of the different application of the remaining national discretions and possibly

lead to further reduction, when sufficient convergence has been achieved. Work includes compiling lists of certain types of exposures, defining terms and developing criteria on specific provisions of the CRD.

#### Validation of IRB and AMA systems

There is a need to develop commonly accepted quantitative and qualitative requirements for discrimination and calibration of rating systems, estimates of probabilities of default (PD), loss given default (LGD), exposure at default (EAD) and AMA parameters. Minimum standards should also be defined for the review of the methodologies applied by credit institutions and investment firms. *Deliverable: guidelines.*

#### External Credit Assessment Institutions (ECAIs)

The new framework for capital adequacy envisages a recognition process for ECAIs. CEBS is developing general principles for ECAIs' recognition, identifying the data set that would be required to assess whether such principles are fulfilled. It will also define a common approach to the ongoing assessment of ECAIs' compliance with the requirements and a common approach towards ECAIs failing to meet them. Finally, general principles will be defined for the mapping of ratings to risk weightings. A channel for co-operation with CESR, which has been mandated by the Commission to provide advice on the general framework for rating agencies, has been established. *Deliverable: guidelines.*

#### Common reporting

Banks with significant cross-border establishments have frequently raised the compliance costs of the reporting of harmonised requirements to different competent authorities according to different structures and with different technological platforms. CEBS is aiming to develop an XML-based solution as a basis for a common reporting framework, and to define a taxonomy of financial and supervisory reporting-related data with a view to proposing a complete package for the implementation of the new solvency ratio. *Deliverable: guidelines*

#### Supervisory disclosure

The proposed Capital Requirements Directive requires competent authorities to disclose information on the implementation of the Directive itself, the exercise of options and discretions and other relevant information in such a way to enable a meaningful comparison of approaches adopted in different Member States. This will be an important element in the process aimed at ensuring consistent implementation of the Directive. CEBS is (i) delineating the elements of supervisory information at stake, (ii) building a framework designed to enable a meaningful comparison of approaches across Member

States and (iii) defining its own role in the implementation of the framework for supervisory disclosure. *Deliverable: guidelines*

Development of IFRS compliant formats. Work will be conducted with a view to streamline financial reporting under IFRS, focusing on harmonisation of reporting formats and convergence of supervisory reporting requirements. In the first stage efforts will be oriented towards the primary reporting formats, like balance sheet and profit and loss accounts. *Deliverable: guidelines*

Supervisory guidance for the new IFRS framework. CEBS will conduct work aimed at supporting common application and interpretation of some components of the IFRS for supervisory purposes. This work will cover areas such as the use of the fair value option, loan accounting and provisioning. The work conducted in the Accounting Task Force of the Basel Committee on Banking Supervision will be taken into due account. *Deliverable: guidelines*

- **Co-operation and information exchange**

Home/host issues

On home/host issues the aim is to develop more cooperative approaches to the supervision of cross-border establishments, including both branches and subsidiaries. The goal is to enhance the two-ways flow of information between home and host authorities, clarifying the operational arrangements allowing the consolidated supervisor to fulfil its role. Specific attention will be devoted to the co-ordination of decisions for the validation of IRB and AMA approaches. *Deliverable: guidelines*

Crisis management

A Memorandum of Understanding on co-operation between banking supervisors and central banks has been prepared by the ESCB Banking Supervision Committee (BSC) and already endorsed. The BSC High Level Working Group on Crisis Management is developing a second MoU aiming at the involvement of finance ministers in information exchange in crisis situations. Two CEBS Members participate in this group. A crisis management exercise conducted by the BSC on the basis of this exercise highlighted areas for further work, in particular principles for co-operation and exchanges of information in cases of crises of large and complex financial organisations. Jointly with the BSC, CEBS will bring forward work contributing to an effective implementation of the recommendation of the Economic and Financial Committee in the area of crisis management, to the convergence of supervisory practices and to the development of effective operational network mechanisms in this area, as well as to the organisation of simulation exercises. *Deliverable: standards.*

Information exchange

Confidential information is already exchanged, in the main working group of CEBS, the Groupe de Contact, which regularly reports to CEBS. CEBS will consider further how to develop its framework for information exchange to ensure that it meets its supervisory objectives in increasingly integrated markets. *Deliverable: note on internal procedures for CEBS.*

## **Other areas of work**

12. Outside the priority areas the Committee identified a large number of work streams and projects that have been started and are being addressed.

### Risks to banking stability

CEBS has been asked to contribute to the review of sectoral risks conducted twice a year by the Financial Stability Table of the Economic and Financial Committee. While a framework for macroprudential analysis of the banking sector falls into the remit of the ESCB Banking Supervision Committee, CEBS will elaborate on the challenges for supervisors and the policy responses to such risks. *Deliverable: reports to the Financial Stability Table*

### Outsourcing

CEBS has already issued a consultation paper containing draft general principles for supervisory approaches and practices in relation to outsourcing. Following the feedback received CEBS will now clarify key concepts, develop guidance on what may be regarded as strategic or core outsourcing activities, and on the concept of a materiality test. Co-operation with the Committee of European Securities Regulators will be needed on this topic. *Deliverable: standards.*

### Internal governance

Pillar 2, and in particular the ICAAP, relies extensively on good principles for internal governance. CEBS is developing guidelines which are designed to meet the specific requirements for internal governance that are included in the Capital Requirements Directive. *Deliverable: embodied in the guidelines on Pillar 2.*

### Impact of IFRS on prudential requirements.

The assessment of the qualitative impact of IFRS on prudential requirements has been conducted within the framework of the advice to the Commission on prudential filters (see above). CEBS intends to perform also a quantitative impact study on the impact on prudential requirements for EU banks. *Deliverable: analytical report.*

### The role of the audit function for prudential supervision.

Taking into account the work already conducted within the Banking Advisory Committee, CEBS will put forward a stock-take exercise on the role of external auditors in the supervisory practices adopted in Member States. Particular attention will be devoted to the role of auditors in validating the information disclosed in relation to the new framework for capital adequacy (so-called Pillar 3). *Deliverable: stock-take report.*

### Cross-sectoral issues

CEBS, together with the other Level 3 Committees for securities and insurance (CESR and CEIOPS), is working on the exchange of information and experiences. The three Level 3 committees are already working together on a number of issues, including conglomerates and off-shore centres.

Conglomerates: The three Level 3 committees are proposing to take up Level 3 tasks in the area of conglomerates. To a large extent, this encompasses the process for supervisory co-operation between all the authorities involved, as well as other tasks more specifically related to the implementation of the conglomerates Directive (the Financial Groups Directive) and the enforcement of the new regulatory framework, particularly in the area of capital adequacy. This work stream is conditional on the agreement of the European Commission to the involvement of CEBS, CESR and CEIOPS in the Level 3 work on conglomerates. *Deliverable: guidelines*

Off-shore centres: After the initiatives of the Financial Action Task Force and the Financial Stability Forum, the need is felt to review at the EU level whether there are still problems with non-co-operative jurisdictions and, if so, whether common EU principles for dealing with such problems should be developed. *Deliverable: Report to the Financial Stability Table.*

### **Monitoring of progress**

13. A table providing a timeline for each project is attached to the work programme and will be regularly updated. Any postponement will be highlighted in the table, together with an explanation. This table is intended to disseminate information on the timing of the different projects and the relative consultation processes, so that interested parties can prepare in advance. It would also play a role of internal governance of the Committee and the Secretariat, to track progress in different areas and to identify possible bottlenecks.
14. Starting from next year, the work programme will also contain a retrospective section discussing any departures from the timelines set out in this work programme (e.g. unplanned work that has been undertaken and/or planned work that has not stayed on track) and the rationale behind this.