



Comments on CP9 “Guidelines for Cooperation between Consolidating Supervisors and Host Supervisors”

The IIF has been involved in dialogue on global capital adequacy standards with the Basel Committee and its subgroups since the beginning of the “Basel II” process. The Institute’s membership includes firms from all major developed and emerging markets, among which are a substantial number of major European institutions. They are internationally active firms that are vitally interested in Basel II. Many deal with multiple home/host situations, and are exposed to potential duplication or fragmentation among regulatory approaches. Given its international vocation, the Institute does not propose to comment on all aspects of CP09, but the Task Force does wish to underscore points of importance to internationally active firms. The Institute appreciates CEBS’s well developed consultation process, and hopes to contribute constructively to the ongoing dialogue.

CEBS’s recognition of the need for supervisory cooperation and greater convergence in supervisory practice, and of the dangers of duplication or inconsistency, is most welcome. In general, CP9 seems a sensible and pragmatic approach and the challenge will be making generally good principles effective across the diverse regulatory cultures and national legal frameworks in the EU. Convergence, by its nature, will be an evolutionary process but the CRD in the EU and Basel II internationally provide an ideal starting point. Of course in the longer run, the industry will wish to revisit the scope of the consolidating regulator role. In the mean time, CEBS should do all it can (and go beyond the present draft of CP9 wherever possible) to heighten the role of the consolidating supervisor in achieving proportionate and risk-based implementation of the CRD, without undue regulatory burdens. Banks would argue, further, that it is more important to achieve convergence of outcomes (and hence of regulatory concepts and procedures for evaluation of firms’ implementation efforts) rather than, necessarily, convergence of specific regulatory means as applied to firms. At the level of requirements applied to firms, a one-size-fits-all approach covering small and large firms is unlikely to reflect the differences between firms’ structures and risk-management sophistication. Whereas something like a more tick-box option may be appropriate for certain small firms, IIF members generally believe that a structured dialogue between firms and regulators on the risks inherent within their businesses is more likely to achieve the joint objectives of regulators and industry.

Global Supervisory Cooperation and Convergence

We have already commented on the need to extend supervisory cooperation and convergence on Pillar 2 to non-EU regulators in our note on CP3 Revised. In the context of CP9, CEBS should explicitly address the issues that arise when the home or the host regulator is non-EU.

One of the prime concerns of the IIF is the actual achievement of the Basel Committee’s goal of a global level playing field. In the EU context, CP9 is a good step in the right direction. CEBS

should play a leading role in seeking convergence of supervisory approaches globally as well. This can and must be done through the AIG in the first instance, but formal (or, where necessary, informal) arrangements with host supervisors outside the EU should be a goal of CEBS as well. Work by CEBS may well determine how fully that goal is achieved. In the CP9 context, CEBS can help develop an international supervisory culture of cooperation on the basis of principles being developed by the AIG, non-discrimination, avoidance of duplication and waste, recognition of the perils of inconsistency, and acknowledgement that Basel II requires efficient use of scarce resources across international groups – both the bank’s and the supervisors’ resources. CEBS can use the platform of CP9 to make a general aspirational statement of these principles with respect to relations between EU and third-country supervisors.

Clarity of supervisory role-definition, coordination in information gathering and information sharing, and consistency in decision making are essential goals for all supervisors. CEBS is uniquely situated to help the international system attain those goals. Working with third-country supervisors involves accommodating different legal structures, but supervisory efficiency – and truly effective, proportionate regulation – can only be achieved if supervisors think and act globally. There is no international Article 129, but much can be achieved by informal means to achieve coordination and mutual reliance among supervisors, in order to achieve supervisory goals more coherently and to avoid unnecessary regulatory burdens on the industry. Maximum use should be made of the AIG to achieve common understandings and convergence of supervisory approaches. In a longer time-frame, it will be desirable for the EU authorities, including CEBS, to develop more formal relationships for cross-border implementation of Basel II, but, if that process develops, it should be kept under the global coordinating umbrella as much as possible, in order to avoid the danger of uncoordinated bilateral or ad-hoc multilateral processes among regulators that could further undermine the level playing field.

While CEBS has no formal powers outside the EU, its leadership and its representation of 25 important supervisors give it an extraordinary role to play on the critical issue of “narrowing the range” of supervisory practice and procedure, as AIG Chairman Nick Le Pan has urged, especially in areas where the Basel Accord leaves large degrees of latitude. This recognizes that much supervisory judgment is required for Basel II implementation, but a common supervisory culture, and a mentality that assumes international, cooperative solutions should be the norm are achievable with ongoing, concerted effort. We know that CEBS is actively involved in the AIG and urge it to continue to put a top priority on furthering the AIG’s work of assuring a converging path rather than diverging paths to Basel II implementation.

Similarly, CEBS should find ways to mitigate the impact of national deviations from the Accord, such as the US implementation schedule, the non-adoption of the AMA for practical purposes by some supervisors, or the decision by certain non-G10 supervisors to opt out of certain features of the international accord, such as the IMM for the Trading Book. With respect to the EU/US “gap year” and the US extension of the “floors”, for example, both a good deal of pragmatism by EU regulators and perhaps some clearly negotiated understandings of how discontinuities can be lived with by transatlantic firms will be in order. The Task Force expects a clear and formal regulatory dialogue between the US and the EU would solve the home/host issues that will arise from the divergence of implementation schedules.

“Better Regulation”

CEBS cannot be the “project manager” of home/host issues around the globe, but it can provide good schemas for the management of the relationship. CP9 already does a good deal of this and it should help propagate a better awareness of impact analysis, the need to conserve resources, the

negative impact of excessive regulatory burdens on good regulatory outcomes, and the other perceptions of the “better regulation” movement, on which CEBS has already provided useful commentary.

In so doing, while providing as much clarity as possible on the supervisory side of the equation, it should keep in mind that solutions to home/host problems (or Pillar 2 problems or the issues addressed in CP10) should not add to the quantity of existing rules. Nor should it add prescriptiveness where the underlying rules attempt to state principles. While setting aspirational standards for coordination and convergence among supervisors, it should avoid new burdens on banks. Thus, consistency of supervisory understanding on the maximum standards for detail that would normally be asked of banks (in respect of validations, for example) would be an appropriate complement to an understanding of the minimum standards for cooperation among supervisors. If there is an apparent asymmetry in this, it is a necessary one and reflects a need for increasingly shared international supervisory norms of effective but not burdensome regulation. Thus, convergence of supervisory practices must not undermine the principles-based approach. The Task Force believes that the consolidating supervisor can play an important role in preventing any such adverse development.

The importance of proportionality (and its sub-set, materiality) cannot be over-emphasized. This is essential to the conservation of supervisory resources as well as to delivering good regulation at an acceptable cost at the institution’s level. These principles are recognized in CP9, but should be systematically incorporated in all aspects of home-host practice among EU supervisors and in developing supervisory cooperation.

To take only one example, CEBS is entirely correct that information gathering from banks and communication among supervisors must be proportionate and risk-based to avoid unnecessary information flow. Best practices should aim at identifying “must-have” information more clearly and encouraging sampling or summarization by the consolidating supervisor. Helpful though CP9 already is on this point, it could be made clearer that indiscriminate calls for information are costly and ultimately inimical to effective regulation as well as contrary to the spirit of proportionate regulation.

Specific Observations

The Institute has commented separately on CP10 with respect to IRB and AMA issues. Here follow a few more comments on CP9.

Group-Based Risk Management. CP9’s recognition that “banking groups are centralizing their risk management activity [so] there is a need to develop further an integrated, risk-based and coordinated approach to supervision” is fundamental. As discussed in our paper on CP3 Revised and our correspondence with the Basel Working Group on Corporate Governance, regulation must adapt to the fact that risk management (and treasury and other related functions) can, in general, only be carried out on a group-wide basis. While local responsibilities toward host regulators must certainly be honored, it is also the case that the technical demands of risk-based capital requirements in and of themselves are a major reason that banks choose to centralize such functions (with some exceptions depending on the business needs of each bank). It is important, but not sufficient, to say that supervisory arrangements should be neutral as to the group’s business model and structure; in addition, several points of CP9 necessarily lead to the conclusion that regulation must be adapted to the exigencies of modern risk management at the group level.

Supervisory Transparency. CEBS’s approach to supervisory transparency is an important contribution, which should be generalized outside the EU as well. This has both a specific and a general dimension. At the specific-firm level, a well conceived framework for supervisory cooperation for a specific group would be a framework that is clear and well understood not only by the supervisors concerned, but by the group as well. Sharing MOUs between the consolidating supervisor and host supervisors with the firms concerned to the maximum extent that is feasible would be helpful to this end. At a more macro level, the public expectations set by CEBS for supervisory coordination, cooperation and convergence should be as transparent as possible. CP9 goes a good distance in that direction, particularly at paragraph 37(iv). CEBS’s recently published guidelines on supervisory disclosure are also very useful in this regard.

Significance/Relevance. At several points, following the lead of CRD, the concepts of the significance or systemic relevance of entities within groups and within local markets are raised. We believe that these concepts are critical in limiting the activities of host regulators to what is strictly necessary. CEBS should develop clear guidance on how these concepts should be applied in practice. While the difficulty of an overall definition of “significance” or “relevance” for these purposes is recognized, it must also be recognized that leaving such concepts open-ended is ultimately contrary to the proportionality concept and likely to undermine the convergent implementation of the CRD. CEBS should note what appears to be happening to the “hybrid AMA” concept published by the Basel Committee: it appears to be less than likely to be taken up in many jurisdictions outside the EU, specifically because no international consensus on the “significance” of subsidiaries has been reached. While CP9 gives some useful guidance of a general sort on this point and gives a good directional push, reliance only on hortatory guidance carries the risk that in the long run centrifugal forces will take over, with unfortunate effects for the coherence, convergence, and efficiency of bank regulation.¹

This is an area where clearer guidelines for supervisory process should be established, provided of course that such guidelines appropriately recognize the importance of the banking group in determining not only effective risk management but also competitiveness.² Supervisors may not be able to place quantitative limits on the determination of “significance”, but they can use qualitative, strategic reasoning to determine the treatment of a subsidiary within a group, as banking groups already do for determining the treatment of their subsidiaries. The consolidating supervisor should play a key role in this process, in cooperation with the host supervisors, always taking into account the opinion of the banking organization itself.

Branches. At several points, CP9 discusses the needs of host supervisors in the regulation of branches, particularly locally significant branches (which points out, among other things, the excessive subjectivity of determining “significance”). It is helpful that paragraph 57 establishes the principle that the intervention of branch supervisors should never entail any additional burden on the group or entity concerned. CEBS should ensure that the role of host supervisors in the regulation of branches is limited to what is necessary. We see a role for CEBS in doing the same

¹ Note that in suggesting additional guidance to supervisors on the determination of significance and relevance for purposes of allocations of roles between home and host supervisors or related purposes, we should not be understood to be asking for specific benchmarks of materiality at the level of the firm. At that level, it is important for the firm to have the right to set its own materiality thresholds (subject, of course, to defending them to its supervisor where required). The present paragraph, however, addresses issues of significance and relevance as determined at the supervisory level.

² By way of illustration of the competitiveness point, we refer to Commissioner McCreevy’s speech of October 17, 2005 at Dublin, which (while making a different point) emphasizes that competitiveness must transcend Member States’ local markets.

with respect to non-EU countries, for instance through its influence in the AIG. While concerns about systemic branches are appropriate, and certainly reasonable accommodations must be made for local concerns in the regulation of branches (especially with respect to information exchange among supervisors), it is important that European regulators not step back from the principles of the single license, which are already well established in practice as well as law.

Tables. On the whole the tables are a useful starting point in providing guidance to regulators on the nature and timing of interaction in the process of supervision of groups. They should not be considered locked in stone, of course, and should be revisited periodically as, one hopes, experience will show where efficiencies can be gained. In addition, they might usefully be extended to include guidance for such matters as how terms of reference are to be documented and agreed for delegated work; encouraging reliance on other regulators for certain types of work; and setting “service standards”, for example, turn-around times for tasks such as information sharing.

While it is recognized that arbitration of disagreements among supervisors is a difficult question, a constructive step in that direction would be to set out in the tables normal escalation procedures and expected schedules, even if an ultimate arbitrator cannot be mandated for all issues (setting aside Art. 129 of course). In any case, the key role of the consolidating supervisor in a conflict situation should never be undermined.