23 April 2009

Current status of CEBS work in relation to the de Larosière recommendations

Hereafter we present the work CEBS has already undertaken or has planned to undertake in the different areas that are addressed by the de Larosière recommendations.

DISCLAIMER: This overview does not provide an opinion by CEBS on the de Larosière recommendations.

No.	Recommendation	CEBS Action
1	The Group sees the need for a fundamental review of the Basel 2 rules. The Basel Committee of Banking Supervisors should therefore be invited to urgently amend the rules with a view to: i. gradually increase minimum capital requirements; ii. reduce pro-cyclicality, by e.g. encouraging dynamic provisioning or capital buffers; iii. introduce stricter rules for off-balance sheet items; iv. tighten norms on liquidity management; and v. strengthen the rules for bank's internal control and risk management, notably by reinforcing the "fit and proper" criteria for management and board members. Furthermore, it is essential that rules are complemented by more reliance on judgement.	At the European level and in liaison with the work of the BCBS, CEBS is leading or participating in a series of initiatives in this area: i. CEBS will provide input to the revision of the trading book requirements at the European level ii. CEBS is participating in the EU working group on pro-cyclicality, which is considering the introduction of dynamic provisioning and capital buffers. In addition, CEBS has also established its own working group on cyclicality issues. iii. CEBS will design guidelines on the treatment of securitisation activities in the revised CRD. iv. CEBS is currently working on enhancing liquidity risk management and considering a definition of liquidity buffers. v. CEBS has published its work plan for enhancing its risk management guidelines

2	In the EU, a common definition of regulatory capital should be adopted, clarifying whether, and if so which, hybrid instruments should be considered as tier 1 capital. This definition should be confirmed by the Basel Committee.	CEBS is currently working on clarifying and harmonising the conditions for considering hybrid instruments as Tier 1 capital and adopting a common definition of core Tier 1 capital. This work is undertaken in liaison with the BCBS.
3	Concerning the regulation of Credit Rating Agencies (CRAs), the Group recommends that: i. within the EU, a strengthened CESR should be in charge of registering and supervising CRAs; ii. a fundamental review of CRAs' business model, its financing and of the scope for separating rating and advisory activities should be undertaken; iii. the use of ratings in financial regulations should be significantly reduced over time; iv. the rating for structured products should be transformed by introducing distinct codes for such products. It is crucial that these regulatory changes are accompanied by increased due diligence and judgement by investors and improved supervision.	CEBS is monitoring the changes to the regulation of CRAs, given their impacts on the process for ECAI recognition in the CRD.
4	With respect to accounting rules the Group considers that a wider reflection on the mark-to-market principle is needed and in particular recommends that: i. expeditious solutions should be found to the remaining accounting issues concerning complex products; ii. accounting standards should not bias business models, promote pro-cyclical behaviour or discourage long-term investment; iii. the IASB and other accounting standard setters should clarify and agree on a common, transparent methodology for the valuation of assets in illiquid markets where mark-to market cannot be applied; iv. the IASB further opens its standard-setting process to the regulatory, supervisory and business communities; v. the oversight and governance structure of the IASB be strengthened.	In June 2008, CEBS published a report on the valuation of complex or illiquid instruments and other related accounting issues. The report made several recommendations that go in the direction of the recommendations included in the de Larosière Group's report. CEBS published in March 2009 an update of its report and noted that a significant number of its recommendations had not yet been fully addressed. In addition, CEBS usually comments on IASB papers.
5	The Group considers that the Solvency 2 directive must be adopted and include a balanced group support regime, coupled with sufficient safeguards for host Member States, a binding	

	mediation process between supervisors and the setting-up of harmonised insurance guarantee schemes.	
6	The Group considers that: i. Competent authorities in all Member States must have sufficient supervisory powers, including sanctions, to ensure the compliance of financial institutions with the applicable rules; ii. Competent authorities should also be equipped with strong, equivalent and deterrent sanction regimes to counter all types of financial crime.	CEBS report on its members' supervisory powers was submitted to the European Commission and published on 6 March 2009. The report, that is providing input to the forthcoming White Paper of the Commission on early intervention tools, noted some differences in powers and that there was not a common definition of sanctions.
7	Concerning the "parallel banking system" the Group recommends to: i. extend appropriate regulation, in a proportionate manner, to all firms or entities conducting financial activities of a potentially systemic nature, even if they have no direct dealings with the public at large; ii. improve transparency in all financial markets iii. and notably for systemically important hedge funds - by imposing, in all EU Member States and internationally, registration and information requirements on hedge fund managers, concerning their strategies, methods and leverage, including their worldwide activities; iv. introduce appropriate capital requirements on banks owning or operating a hedge fund or being otherwise engaged in significant proprietary trading and to closely monitor them.	i. CEBS is currently looking at the Scope of supervision and provided to the EFC and the EU Commission a proposal for criteria for assessing whether a certain activity has a material impact with respect to banks (and is covered by consolidated supervision) or, if not, whether there is a need for a direct application of prudential regulation/supervision. ii. CEBS published a paper on good practices on transparency in June 2008 and is monitoring the progress made by the industry. In March 2009 CEBS published the outcome of its third assessment of banks' transparency on exposures affected by the financial crisis. On the basis of banks' audited annual reports and Pillar 3 reports, CEBS will continue to assess whether gaps that have been identified in the previous analysis have been satisfactorily addressed, and will decide on a potential follow up. CEBS has done much work on transparency and stands ready to assist improvements in this area.
8	Concerning securitised products and derivatives markets, the Group recommends to: i. simplify and standardise over-the-counter derivatives; ii. introduce and require the use of at least one well-capitalised central clearing house for credit default swaps in the EU;	Following up to the revision of the CRD, CEBS will issue guidelines on the prudential treatment of securitisation, notably on retention clauses.

	iii. guarantee that issuers of securitised products retain on their books for the life of the instrument a meaningful amount of the underlying risk (non-hedged).	
9	With respect to investment funds, the Group proposes to further develop common rules for investment funds in the EU, notably concerning definitions, codification of assets and rules for delegation. This should be accompanied by a tighter supervisory control over the independent role of depositories and custodians.	CEBS and CESR have provided advice on Custodians where they analysed the impact the application of the current CRD provisions would have on specialist commodity derivatives firms. CEBS is also making sure that the changes made to the ECB-CESR recommendations for CCP are reflected in the banking regulation.
10	In order to tackle the current absence of a truly harmonised set of core rules in the EU, the Group recommends that: i. Member States and the European Parliament should avoid in the future legislation that permits inconsistent transposition and application; ii. the Commission and the level 3 Committees should identify those national exceptions, the removal of which would improve the functioning of the single financial market; reduce distortions of competition and regulatory arbitrage; or improve the efficiency of cross-border financial activity in the EU. iii. Notwithstanding, a Member State should be able to adopt more stringent national regulatory measures considered to be domestically appropriate for safeguarding financial stability as long as the principles of the internal market and agreed minimum core standards are respected.	CEBS has given several advice to the EC on reduction of a significant number of national discretions and options in the CRD. CEBS stands ready to further assist on this issue.
11	In view of the corporate governance failures revealed by the current financial crisis, the Group considers that compensation incentives must be better aligned with shareholder interests and long-term firm-wide profitability by basing the structure of financial sector compensation schemes on the following principles: i. the assessment of bonuses should be set in a multi-year framework, spreading bonus payments over the cycle; ii. the same principles should apply to proprietary traders and asset managers; iii. bonuses should reflect actual performance and not be guaranteed in advance. Supervisors should oversee the suitability of financial institutions' compensation policies, require changes where compensation policies encourage excessive risk-taking and, where necessary, impose additional capital requirements under pillar 2 of Basel 2 in case no adequate remedial action is being taken.	CEBS published on 20 April 2009 a set of principles for remuneration policies following a one-month public consultation period and a public hearing. The principles address key aspects of well functioning remuneration policies and thus support the sound operation of banking institutions. CEBS will further consider implementation aspects of these guidelines in a Pillar 2 context in the coming months.

12	With respect to internal risk management, the Group recommends that: i. the risk management function within financial institutions must be made independent and responsible for effective, independent stress testing; ii. senior risk officers should hold a very high rank in the company hierarchy, and iii. internal risk assessment and proper due diligence must not be neglected by over reliance on external ratings. Supervisors are called upon to frequently inspect financial institutions' internal risk management systems.	CEBS is undertaking work on enhancing internal risk management practices and on stress testing. CEBS has conducted an analysis of existing risk management guidelines, with the objective of identifying possible gaps in coverage and other areas where updates to the guidelines would be desirable. The report was submitted to the EFC in March 2009 and provides a roadmap for improving existing CEBS guidance, including (i) development of the high-level principles on risk management, (ii) consolidating guidelines and principles currently scattered across different documents in to a comprehensive guidebook, (iii) updating and revising existing guidelines to take into account issues highlighted by the crisis, and (iv) transposing some guidelines issued by other regulatory fora into the CEBS guidance framework. CEBS has also prepared a report, focused on stress-testing practices during the crisis, which identified the need for enhancing CEBS guidelines in this area.
13	The Group calls for a coherent and workable regulatory framework for crisis management in the EU: i. without pre-judging the intervention in future individual cases of distressed financial institutions, a transparent and clear framework for managing crises should be developed; ii. all relevant authorities in the EU should be equipped with appropriate and equivalent crisis prevention and crisis intervention tools; iii. legal obstacles which stand in the way of using these tools in a cross-border context should be removed, with adequate measures to be adopted at EU level.	CEBS is actively assisting the EC on its planned June 2009 White Paper on Early interventions, and has submitted some comments to the EC on 20th March 2009. Further, CEBS submitted its report to the EC on 6 March 2009 mapping supervisory objectives and powers, including early intervention and sanctioning powers, along with the related questionnaires completed by CEBS' Members.
14	Deposit Guarantee Schemes (DGS) in the EU should be harmonised and preferably be pre-funded by the private sector (in exceptional cases topped up by the State) and provide high, equal protection to all bank customers throughout the EU. The principle of high, equal protection of all customers should also be implemented in the insurance and investment sectors. The Group recognises that the present arrangements for safeguarding the interests of depositors in host countries have not proved robust in all cases, and recommends that the existing powers of host countries in respect of branches be reviewed to deal with the problems which have occurred in this context.	CEBS is actively assisting the EC on its planned June 2009 White Paper on Early interventions, and has submitted some comments to the EC on 20th March 2009. In its comments, CEBS noted that the recent review of the Deposit Guarantee Schemes Directive (DGSD) revealed no current consensus on how national DGS should be funded. CEBS notes that the Commission has proposed to submit a report on the harmonisation of funding mechanisms of Deposit Guarantee Schemes and the possible introduction of a Community scheme.

		Alongside that report, CEBS believes that the Commission could usefully examine the case for national DGS to be able to contribute to the costs of non-payout measures. Any proposal for greater harmonisation should at least ensure that the ability of national DGS to contribute to intervention measures is not reduced, but may strengthen the case for harmonisation of related industry funds.
15	In view of the absence of an EU-level mechanisms for financing cross-border crisis resolution efforts, Member States should agree on more detailed criteria for burden sharing than those contained in the existing Memorandum of Understanding (MoU) and amend the MoU accordingly.	CEBS initial lessons learnt from the crisis recognised that the current High Level MoU has not been effective and supports this being reviewed.
16	A new body called the European Systemic Risk Council (ESRC), to be chaired by the ECB President, should be set up under the auspices and with the logistical support of the ECB. i. The ESRC should be composed of the members of the General Council of the ECB, the chairpersons of CEBS, CEIOPS and CESR as well as one representative of the European Commission. Whenever the subject discussed justifies the presence of insurance and securities supervisors, the Governor could choose to be represented by the Head of the appropriate national supervisory authority; ii. The ESRC should pool and analyse all information, relevant for financial stability, pertaining to macro-economic conditions and to macro-prudential developments in all the financial sectors. iii. A proper flow of information between the ESRC and the micro-prudential supervisors must be ensured.	See CEBS main comments as presented in the Annex of the 3L3 Joint Contribution of 10 April 2009.
17	An effective risk warning system shall be put in place under the auspices of the ESRC and of the Economic and Financial Committee (EFC). i. The ESRC should prioritise and issue macro-prudential risk warnings: there should be mandatory follow up and, where appropriate, action shall be taken by the relevant competent authorities in the EU. ii. If the risks are of a serious nature, potentially having a negative impact on the financial sector or the economy as a whole, the ESRC shall inform the chairman of the EFC. The EFC, working with the Commission, will then implement a strategy ensuring that the risks are effectively addressed. iii. If the risks identified relate to a global dysfunction of the monetary and financial system, the ESRC will warn the IMF, the FSF and the BIS in order to define appropriate action at both EU and global levels.	See CEBS main comments as presented in the Annex of the 3L3 Joint Contribution of 10 April 2009.

	iv. If the ESRC judges that the response of a national supervisor to a priority risk warning is inadequate, it shall, after discussion with that supervisor, inform the chairman of the EFC, with a view to further action being taken against that supervisor.	
18	A European System of Financial Supervisors (ESFS) should be setup. This ESFS should be a decentralised network: - existing national supervisors would continue to carry-out day-to-day supervision; - three new European Authorities would be set up, replacing CEBS, CEIOPS and CESR, with the role coordinate the application of supervisory standards and guarantee strong cooperation between the national supervisors; - colleges of supervisors would be set up for all major cross-border institutions. The ESFS will need to be independent of the political authorities, but be accountable to them. It should rely on a common set of core harmonised rules and have access to high-quality information.	See CEBS main comments as presented in the Annex of the 3L3 Joint Contribution of 10 April 2009.
19	In the first stage (2009-2010), national supervisory authorities should be strengthened with a view to upgrading the quality of supervision in the EU. Member States should give consideration to the following reforms: i. aligning supervisors' competences and powers on the most comprehensive system in the EU, increasing supervisors' remuneration, facilitating exchanges of personnel between the private sector and supervisory authorities, ensuring that all supervisory authorities implement a modern and attractive personnel policy. ii. The level 3 committees should intensify their efforts in the areas of training and personnel exchanges. They should also work towards the creation of a strong European supervisory culture. iii. The European Commission should carry-out, in cooperation with the level 3 committees, an examination of the degree of independence of all national supervisors. This should lead to concrete recommendations, including on the funding of national authorities. In this first stage, the European Commission should immediately begin the work to prepare legal proposals to set up the new Authorities.	CEBS welcomes the recognition of a need to enhance supervisory resources. CEBS has established for several years a supervisory culture network to facilitate staff exchanges inter alia. CEBS also has a training programme for 2009, and has done so in the last two years. Together with CESR and CEIOPS, it also has a joint 3L3 training programme. The 3L3 have sought some EC funding to assist with their training initiative.

20	In the first stage, EU should also develop a more harmonised set of financial regulations, supervisory powers and sanctioning regimes. i. The European Institutions and the level 3 committees should initiate a determined effort to equip the EU with a far more consistent set of rules by the beginning of 2013. ii. Key differences in national legislation stemming from exceptions, derogations, additions made at national level or ambiguities contained in current directives should be identified and removed, so a harmonized core set of standards is defined and applied throughout the EU. iii. The European Institutions should set in motion a process leading to far stronger and consistent supervisory and sanctioning regimes in the Member States.	See CEBS main comments as presented in the Annex of the 3L3 Joint Contribution of 10 April 2009. As noted in CEBS report to the EC mapping supervisory objectives and powers, including sanctioning powers, submitted to the EC on 6th March 2009, CEBS welcomes steps to ensure a more consistent sanctioning regime. Please note comments on national discretions (recommendation 10).
21	The Group recommends an immediate step-change in the working of the level 3 committees which can be dealt with at once. The level 3 committees should therefore: i. benefit from, under the Community budget, a significant reinforcement of their resources; ii. upgrade the quality and impact of their peer review processes; iii. prepare the ground, including through the adoption of adequate supervisory norms, for the setting-up of supervisory colleges for all major cross-border financial firms in the EU by the end of 2009.	i. CEBS welcomes recognition that it needs an increase in its resource. ii. CEBS has established a peer review mechanism in 2007 and has been performing peer review since then. iii. CEBS Members have been setting up colleges for banking groups for several years. CEBS has set up a process to establish and monitor by end 2009 supervisory colleges for the largest EU cross border banking groups. Further CEBS is currently working on undertaking peer review on colleges, and will issue guidelines on joint assessment and joint decision on pillar 2 by the end of 2009.
22	In the second stage (2011-2012), the EU should establish an integrated European System of Financial Supervision (ESFS). - The level 3 Committees should be transformed into three European Authorities: a European Banking Authority, a European Insurance Authority and a European Securities Authority. - The Authorities should be managed by a board comprised of the chairs of the national supervisory authorities. The chairpersons and director generals of the Authorities should be full-time independent professionals. The appointment of the chairpersons should be confirmed by the Commission, the European Parliament and the Council and should be valid for a period of 8 years.	See CEBS main comments as presented in the Annex of the 3L3 Joint Contribution of 10 April 2009. With respect to the proposed competencies of the Authorities, CEBS currently has: • established a mediation mechanism in 2007 • monitored the functioning of colleges for several years, and has established a process to set up by end 2009 supervisory colleges for the largest EU cross border banking groups. CEBS is currently working on undertaking peer review on colleges,

	- The Authorities should have their own autonomous budget, commensurate with their responsibilities. In addition to the competences currently exercised by the level 3 committees, the Authorities should have, inter alia, the following key-competences: i) legally binding mediation between national supervisors; ii adoption of binding supervisory standards; iii) adoption of binding technical decisions applicable to individual financial institutions; iv) oversight and coordination of colleges of supervisors; v) designation, where needed, of group supervisors; vi) licensing and supervision of specific EU-wide institutions (e.g. Credit Rating Agencies, and post-trading infrastructures); vii) binding cooperation with the ESRC to ensure adequate macro-prudential supervision. - National supervisory authorities should continue to be fully responsible for the day-today supervision of firms.	and the CEBS secretariat members have recently started attending supervisory colleges.
23	The Group recommends that planning for the 2 stages of the new system be started immediately. To this effect, a group of high-level representatives of the Finance Ministries, the European Parliament, the Level 3 Committees, and the ECB to be chaired by the Commission, should come forward before the end of 2009 with a detailed implementation plan.	CEBS stands ready to be fully involved in such planning and actively participate in this transformation process.
24	The functioning of the ESFS should be reviewed no later than 3 years after its entry into force. In the light of this review, the following additional reforms might be considered: - Moving towards a system which would rely on only two Authorities: the first Authority would be responsible for banking and insurance prudential issues as well as for any other issue relevant for financial stability; the second Authority would be responsible for conduct of business and market issues; - Granting the Authorities with wider regulatory powers of horizontal application; - Examining the case for wider supervisory duties at the EU level.	
25	The Group recommends that, based on clear objectives and timetables, the Financial Stability Forum (FSF), in conjunction with international standard setters like the Basel Committee of Banking Supervisors, is put in charge of promoting the convergence of international financial regulation to the highest level benchmarks.	

	In view of the heightened role proposed in this report for the FSF, it is important that the FSF is enlarged to include all systemically important countries and the European Commission. It should receive more resources and its accountability and governance should be reformed by more closely linking it to the IMF. The FSF should regularly report to the IMF's International Monetary and Financial Committee (IMFC) about the progress made in regulatory reform implementing the lessons from the current financial crisis. The IMFC should be transformed into a decision-making Council, in line with the Articles of the IMF agreement.	
26	Barring a fundamental change in the ways that banks operate, the Group recommends that the colleges of supervisors for large complex cross-border financial groups currently being set up at the international level should carry out robust comprehensive risk assessments, should pay greater attention to banks' internal risk management practices and should agree on a common approach to promoting incentive alignment in private sector remuneration schemes via pillar 2 of Basel 2. The Financial Stability Forum (FSF), working closely with other relevant international bodies, should ensure coherent global supervisory practice between the various colleges and promote best practice.	CEBS has agreed a list of cross border EU banks, for which colleges will be set up at the latest by the end of 2009, of which a large number are already in place. - the CEBS secretariat will prepare a stock take to have a full overview of all EU cross border banking groups. - members of the CEBS secretariat have recently started attending individual colleges, not only to see their functioning in practice but also to present the CEBS work completed and under construction. CEBS has developed a paper identifying good practices, that some supervisors have adopted with respect to the functioning of colleges, which it published on 2rd April 2009. CEBS published on 20 April 2009 a set of principles for remuneration policies following a one-month public consultation period and a public hearing. The principles address key aspects of well functioning remuneration policies and thus support the sound operation of banking institutions. CEBS will further consider implementation aspects of these guidelines in a Pillar 2 context in the coming months.
27	The Group recommends that the IMF, in close cooperation with other interested bodies, notably the FSF, the BIS, central banks and the European Systemic Risk Council (ESRC), is put in charge of developing and operating a financial stability early warning system, accompanied by an international risk map and credit register. The early warning system should aim to deliver clear messages to policy makers and to recommend pre-emptive policy responses, possibly triggered by pre-defined "danger zones".	

	All IMF member countries should commit themselves to support the IMF in undertaking its independent analysis (incl. the Financial Sector Assessment Programme). Member countries should publicly provide reasons whenever they do not follow these recommendations. The IMFC/Council should receive a report, one or twice a year, on this matter.	
28	The Group recommends intensifying co-ordinated efforts to encourage currently poorly regulated or "uncooperative" jurisdictions to adhere to the highest level international standards and to exchange information among supervisors. In any event, in order to account for the increased risks, group supervisors should increase capital requirements for those financial institutions investing in or doing business with poorly regulated or supervised financial centres whenever they are not satisfied by the due diligence performed or where they are unable to obtain or exchange pertinent information from supervisors in these offshore jurisdictions. The IMF and the FSF, in cooperation with other relevant international bodies, should assess the existing regulatory standards in financial centres, monitor the effectiveness of existing mechanisms of enforcing international standards and recommend more restrictive measures where the existing applied standards are considered to be insufficient.	CEBS, together with CESR and CEIOPS, stands ready to assist to any work from a prudential perspective and repeat its annual exercise (which looks at the developments and possible problems related to the supervision of jurisdictions who are unwilling and/or unable to co-operate , including any respective actions taken by the reporting authority or other EU authorities).
29	The Group recommends that EU Member States should show their support for strengthening the role of the IMF in macroeconomic surveillance and to contribute towards increasing the IMF's resources in order to strengthen its capacity to support member countries facing acute financial or balance of payment distress.	-
30	The Group recommends that a coherent EU representation in the new global economic and financial architecture be organised. In the context of a more ambitious institutional reform, this could imply a consolidation of the EU's representation in the IMF and other multilateral fora.	See CEBS main comments as presented in the Annex of the 3L3 Joint Contribution of 10 April 2009.
31	In its bilateral relations, the EU should intensify its financial regulatory dialogue with key partners.	See CEBS main comments as presented in the Annex of the 3L3 Joint Contribution of 10 April 2009.