

## EPFSF Briefing Supervisory Convergence

### History of Supervisory Convergence

It is not clear where the term “supervisory convergence” was first used, but the concept has come to greater prominence since the inception of the Lamfalussy Process which established the Level 3 Committees with charters to encourage supervisory cooperation and convergence. The sectoral Committees all built on pre-existing structures of cooperation (e.g. the “Groupe de Contact” in banking and FESCO in securities) and thus the formalisation of the cooperative structure became an opportunity to promote a greater degree of cooperation.

References to supervisory convergence have continued and increased, building on the opportunities created by the Lamfalussy architecture. The EC White Paper on Financial Services policy 2005 – 2010, the Financial Services Committee Report on Financial Supervision (Francq Report), successive IIMG reports, and ECOFIN conclusions (notably in December 2007) have all included proposals calling for enhanced convergence and cooperation in supervisory practices. The Level 3 Committees too have been active whether directly as in the CESR 2004 Himalaya Report or indirectly through the delivery of the objectives set out in their charters to deepen cooperation and coordination and enhance supervisory convergence.

### Defining the Term

Despite this increasing body of official documents and reports by the authorities, “supervisory convergence” is not a term that has been defined. As a result there is probably not a “converged” or common understanding of what the term or the process is expected to deliver. CEBS itself noted in its November 2007 paper contributing to the Lamfalussy Review that the industry expectation of supervisory convergence has appeared to shift over time. In order to debate issues related to supervisory convergence it is clearly important to ensure that all parties understand that the term can be understood to apply in several different ways. Thus Supervisory convergence could mean (i) regulatory and supervisory arrangements that are broadly similar or cover the same ground; or (ii) regulatory arrangements and supervisory practices that differ in detail but deliver the same outcomes; or (iii) regulatory requirements and supervisory practices that are the same in form and application.

In more detail this means that supervisory convergence might relate to a range of features of regulation, for example: the rules themselves; how the rules are interpreted; how the rules are enforced in practice; or how regulated entities are expected to comply with the rules. But a further level of issues needs also to be considered, namely:

- Convergence of what – for example of rules, interpretations, practices?
- How and to what extent is convergence formalised?
- How much latitude is left for different approaches?
- What areas of convergence – for example prudential, conduct of business, reporting?

In each case, it is necessary to consider in a practical way what sort of supervisory convergence is most appropriate. CEBS provides one example of how these issues may be analysed in its November 2007 submission to the Lamfalussy Review. In this document CEBS argued that ex-ante targets for convergence need to be defined, that further tools to enable a convergence process should be delivered and that some topics were ripe for “hard convergence.” By “hard convergence” CEBS meant that there would be an identical treatment throughout the EU – for example with respect to prudential reporting.

At the same time, CEBS stated that its view of the industry's attitude in the prudential area was that it had shifted over time from the original objective of enhanced consistency in national approaches and level playing field, to the request that the same business is subject to exactly the same supervisory treatment throughout the EU, so that country neutral arrangements could allow cross-border groups to comply with regulations as smoothly as possible. Therefore, by asking for explicit ex-ante targets, in addition to further supervisory tools, CEBS has proposed an approach that avoids a "one size fits all" solution and which has the capacity to take industry expectations into explicit account.

Some practical examples of where authorities might grapple with setting targets for convergence in the field of prudential supervision include circumstances when individual firms (banks or investment firms) should be subject to a higher than 8% minimum capital requirement; methods of approval for advanced calculation methodologies (e.g. Value at Risk or Internal Ratings); whether on site inspections of firms could be carried out by a single supervisory authority for the whole group (and if so whether by the local supervisor or the consolidating supervisor) or could be delegated to external auditors. These matters are not prescribed in EU legislation, and differing resources, local legislation and systemic implications of major cross border groups are all factors that will come into play when deciding how the coordination and convergence of a particular set of supervisory actions relating to a financial group will be organised.

### **Why is there an impetus for Convergence?**

The FSAP's introduction of major new pieces of regulation, such as MiFID and CRD, and its impetus for the single market, brought a focus on the potential for variation in application of the legislation. To avoid excessive detail within the Directives, which under Article 249 of the Treaty are addressed to Member States in order to bring about a desired outcome, convergence could be seen as an option to deliver consistency of approach without compromising the enshrined rights of Member States to determine how to achieve these outcomes. Supervisory convergence has been seen as a method of encouraging steady convergence that is based to the greatest extent possible on practical experience of the regulators and the industry, rather than attempting to enshrine lengthy ex ante decisions on micro-supervisory practices into legislation. With respect to existing legislation, National Discretions are regarded as both an obstacle to Convergence but also a motivation to greater efforts of convergence. There are some discretions that can be and are being rendered obsolete by converged supervisory practices and decisions but others require further political debate, bearing in mind that the decisions were ratified by the EU political process in the first instance.

### **What are the challenges?**

With a landscape of disparate supervisory histories and practices born out of different national experiences, it is easy to recognise that supervisory convergence, however defined, could not be achieved overnight. However, depending on the form and extent of supervisory convergence that is attempted, in reducing the divergences and uncertainties (for example, uncertainties in relation to the competent authority whose rules should be followed under the market abuse and takeover regimes) that arise, and in streamlining the supervision of multi-jurisdictional entities, the following factors may also need to be taken into account: legal or even constitutional barriers to tasks being performed in a certain way; a clear analysis and agreement on the detailed objectives of supervision (at a high level, these objectives are probably easy to agree upon); a clear understanding of the priority placed by the different Member States on different aspects of supervision, or risks which require particular attention; committed agreement on the structure, timing, and manner in which supervisory action and surveillance is delivered; and comparable resources.

## Tools, mechanisms and structures to support Convergence

It has been recognised since the outset of the debate on supervisory convergence, that supervisors need tools and structures to assist them. The creation of the Level 3 Committees was one very significant formal step but further efforts have been deemed necessary. The Francq Report outlined a number of practical steps that the Committees have sought to implement and which harnessed the momentum of the work they were already undertaken. Continued work has focused on analysing the mechanisms for fostering joint inspections, common training programmes, staff exchanges, mediation and peer review among supervisors. Thus the current focus of attention is on supporting and enhancing operational networks and colleges of supervisors, which ECOFIN Conclusions from December 2007 and May 2008 have endorsed and which the Commission has also supported. Work by the Level 3 committees on home-host cooperation is a further and continuing vehicle for intensified efforts.

The ECOFIN has proposed ways to improve the efficiency and effectiveness of the Level 3 decision-making process within the existing structure of powers and accountability. In December 2007, the ECOFIN requested the Level 3 committees to introduce in their charters the possibility to apply qualified majority voting, coupled with a comply or explain procedure. In May 2008, the ECOFIN stated that the EU dimension should be taken into account in the national mandates of the supervisors, which should intensify work towards enhanced supervisory convergence and consider financial stability concerns in other Member States in exercising their duties.

## Next steps

Supervisory convergence will remain a topic of interest for industry and regulators alike. There are a range of supervisory initiatives arising from Level 3 Committee activity which are also underpinned in legislation that will encourage supervisory convergence to continue. Thus further attention will be paid to developing home-host relationships, creating colleges of regulators (where they do not already exist) and deepening operational networks that will deliver more regulatory coordination and facilitate ever greater consistency of approach.

Briefing notes are prepared by the Financial Industry Committee to the European Parliamentary Financial Services Forum. For further information on the subjects raised in the briefs please contact the Chairman, Members or Secretariat of the Financial Industry Committee.

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