15 July 2009

Commissioner McCreevy
European Commission
Rue de la Loi 200
BERL 09/104
B-1049 BRUSSELS

markt-g1supervision@ec.europa.eu

Ref.: FRP/HvD/SS/SR

Dear Commissioner,

Re.: EC Communication on European Financial Supervision

(1) FEE (the Federation of European Accountants) is pleased to provide you below with its comments on Communication from the Commission on European Financial Supervision.

General observations

(2) FEE shares the concerns expressed in the De Larosière report about the serious and disruptive implications of the financial crisis, whereby many parts of the financial system have come under severe strain and criticism and still remain so to date.

Global standards

(3) FEE is of the opinion that the financial crisis is a global phenomenon that calls for a global reaction. Global financial markets require financial information prepared in accordance with global standards for reasons of competitiveness and comparability, as well as for capital raising purposes. FEE is strongly committed to high quality, principle-based standards that are generally accepted around the globe, and therefore fully supports the objective of creating a single set of global standards.

(4) We are of the opinion that standard setting, including supervisory and prudential standards, needs to take place at the global level. In the absence of a global governance structure, enforcement can currently only take place at European and national level with a proper balance between the two levels.

(5) We agree with the EC that the European financial supervision structure must be based on high level supervisory standards, applied equivalently, fairly and consistently to all market actors. However we wish to underline that such standards

need to be set at a global level, thus meeting the request of G20 for a more globally consistent, regulatory and supervisory system for the financial sector in future.

(6) FEE supports the policy of more principles-based regulation as this provides the basis for a more robust system, which is better able to cope with changing circumstances. Compliance with principles can be more demanding than applying rules, as a good set of principles addresses the substance rather than the legal form, which rules tend to focus on. Principles-based systems need to be supported by effective supervision, because the application of principles involves an element of judgement.

Better regulation

(7) We share the Presidency conclusions in relation to the European Council meeting of 18 and 19 June that the financial crisis has clearly demonstrated the need to improve the regulation and supervision of (cross border) financial institutions, both in Europe and globally. FEE recognises the need for enhanced coordination and cooperation of national supervisory authorities both at European and at global level in order to be able to oversee the risk in the financial system as a whole.

(8) We support a pan-European financial supervision structure as a stepping stone to a global system. A coordinated European system can be instrumental in taking positions vis-à-vis countries outside Europe and will improve the harmonisation of enforcement decisions within Europe. Regions such as Europe as an economic power has a meaningful contribution to make to the assessment of the building up of global systemic risk and its approach monitor.

(9) FEE supports the efforts to achieve effective, proportionate, and preferably, transnational regulations for all financial sectors to assure sustainable stability and integrity of financial markets. All stakeholders of the regulatory system should be committed to better regulation principles, whereby overregulation should be avoided. The new supervisory framework needs to be proportionate, not impose unnecessary administrative burdens and should not undermine the functioning of the financial markets. Compliance with such regulations needs to be monitored on a continuous basis. Financial regulatory reform efforts must include the development of effective mechanisms to manage the systemic risk of all significant entities that have a role in international capital markets.

(10) FEE notes that both ECOFIN on 9 June and the European Council at its meeting on 18 and 19 June largely supported and endorsed the EC proposals on European financial supervision.

Need for global coordination

(11) FEE is strongly of the opinion that any architecture for a new European financial supervisory framework needs to fit in the global structure of the newly created Financial Stability Board (FSB), with the proposed European authorities coordinating their efforts with FSB. Proper coordination with the global activities needs to be ensured and undue overlap in activities with the global structure should be avoided.

(12) We recognise the wish expressed at the European Council June meeting that the European Union will continue to play a leading role at the global level, in particular within the G20 and that a coordinated EU position be thoroughly prepared in advance of the 24 and 25 September 2009 G20 summit. We welcome the call of the European Council on the EC Commission to take up the issue of global regulation and supervision systematically in their contacts with international partners, including the highest level.

Accountancy profession

(13) Confidence in financial reporting is crucial if financial stability is to be maintained. The role of financial reporting in financial stability is to provide and restore market confidence by providing transparent financial information and a true and fair view on financial performance and position in individual reporting periods. In addition, the audit of such financial information is a significant activity tailored to enhance the credibility of such reporting.

(14) In this context, accounting standard setters and the accountancy profession have a contribution to make in helping to restore this confidence and in helping to understand systemic risk that members of the profession have spotted through their involvement in financial institutions and other entities. They need to operate within the boundaries of confidentiality whilst realising at the same time the impact their findings collectively might have for the market place and country level. However inconvenient the messages about current economic reality may be in the short tem, transparent reporting is a key ingredient for recovery of the system and therefore must be protected and maintained at all times.

(15) In some European countries the relationship between financial institutions, bank auditors and regulators has been generally weakened in recent years. The Basel II Framework does not specifically require the involvement of external auditors for supervisory purposes. However, the audit profession can contribute to greater confidence in banks by providing objective expert opinions on the information reported by banks for supervisory purposes, so that those relying on that information can be confident that it has been properly prepared. Similar observations can be made for the insurance industry. In general we believe that more dialogue between supervisory authorities – at national and at European level – on a wide range of information relevant to supervision and audit of financial services entities should take place, not just in relation to the financial statements themselves.

(16) FEE appreciates the opportunity to contribute within our area of expertise and competence to reflections on how to address in the future any systemic and inter-connected vulnerabilities that were identified during the current crisis including the mispricing of risk and the knowledge gap (at senior levels) due to the complexity of structured financial products. The profession is looking forward to further cooperation with the Supervisory Authorities replacing the Level 3 Committees as well as with the ESRC and the ESFS.

European Systemic Risk Council (ESRC) ("macro-prudential supervision")

(17) The ESRC will have an advisory role in that it would identify risks to financial stability and, where necessary, issue risk warnings and/or recommendations for action to address such risks. The ESRC will be responsible for monitoring compliance with its

recommendations, but will not have any legally binding powers. The so called "act or explain" mechanism means that adequate transparency will be essential to build credibility in, and promote compliance with, its warnings. However, we appreciate that the ESRC will decide on a case by case basis whether this information should be made public given its potential highly sensitive nature. FEE believes that further consideration needs to be given to the ESCR communication mechanisms with the financial markets and other stakeholders.

(18) The ESRC will only be effective if it can identify systemic risks and devise corrective measures and recommendations in a timely manner. At present, the proposals lack clarity as to how the ESRC will achieve this and how it will interact with its global and non-EU equivalent bodies on a timely basis.

(19) We believe that the ESRC as a pan-European macro-prudential supervision body would have to pay sufficient attention to non-banking bodies to ensure that an international capital markets perspective is sufficiently respected. Accordingly, we welcome the involvement of the chairpersons of the three European Supervisory Authorities and of the ESFS, as well as senior representatives of the national supervisory authorities.

(20) Insurance plays a role different from banking in financial markets stability and the insurance sector has different exposure to systemic risk. Therefore, appropriate representation in the ESCR is necessary to consider the consequences and implications of effects and measures on other sectors than banking.

European System of Financial Supervisors (ESFS) ("micro-prudential supervision")

(21) The ESFS is set up as an operational European network with shared and mutually reinforcing responsibilities. The three existing Level 3 committees will be converted into Supervisory Authorities. We underline the need for greater consistency and coordination across the EU and better methods for monitoring and coordinating between national supervisory authorities. We note that the European Council at its June meeting invites the Commission to make concrete proposals for how the ESFS could play a strong coordinating role among supervisors in crisis situations. We agree that the supervisory structure should be subject to periodic re-appraisals.

(22) We welcome the decision to give legal status to the three Supervisory Authorities, with increased responsibilities, defined legal powers and greater authority, with pre-eminence of national supervisors in terms of day-to-day supervision remaining at the national level. The financial consequences of the new model need to be carefully considered. For example, it will be necessary to determine to what extent the Supervisory Authorities should continue to rely on resources and input from national supervisors.

(23) We believe that to improve communication and coordination among the Supervisory Authorities and national supervisory authorities, clear definitions of respective responsibilities are crucial. There needs to be an appropriate balance between the ESFS and the national supervisory authorities. The practical consequences of splitting powers between the national and European level need to be examined including a robust mechanism of reaction from national supervisory authorities to ensure that warning signals are properly considered and acted upon. Further clarification on which body has the ultimate responsibility is needed in a number of detailed areas.

Avenue d'Auderghem 22-28 • B-1040 Brussels • Tel: +32 (0)2 285 40 85 • Fax: +32 (0)2 231 11 12 • secretariat@fee.be • www.fee.be
Association Internationale reconnue par Arrêté Royal en date du 30 décembre 1986

(24) We note that the EC considered three possible models for the most appropriate supervisory structure: one single supervisor for all sectors; separate supervisors for prudential and conduct-of-business supervision; and a sectoral approach. The EC opted for the sectoral approach with separate supervisors for banking, insurance companies and securities activities, building upon the existing structures given that there is no persuasive evidence to suggest that other structures would be more efficient for the specific competences which are proposed for the European Supervisory Authorities. Since business models, risks and supervisory objectives are different between sectors, industry specific solutions are required.

(25) We note, however, that institutions can be involved in all three domains: banking, insurance and fund management. Due to their size financial conglomerates are potentially a key constituent in systemic risk. We are concerned about a lack of specific focus on financial conglomerates in terms of the ESFS, the ESRC and the Steering Committee. Duplication of reporting due to involvement of different authorities should be avoided to the maximum extent possible.

(26) We observe that the Solvency II Framework Directive has only recently been adopted. The experience with the harmonised solvency rules and supervision in the insurance domain may be of benefit to the European Financial Supervision structure.

In summary

(27) We agree with the EC conclusion underlining the importance of a truly integrated approach to European financial supervision: the need for strong interaction between the ESRC and the ESFS including the exchange of micro-prudential information relevant for macro-prudential analysis; the willingness of the relevant parties to act upon risk warnings and recommendations; and the need for the ESRC to act as an interface with international institutions notably the FSB and IMF.

For further information on this letter, please contact Ms. Saskia Slomp, Technical Director.

Yours sincerely,

Hans van Damme
President