Consultation: Report of the High-Level Group on Financial Supervision in the EU (de Larosière Report)

We appreciate the opportunity to comment on this important consultation on the improvement of supervision for the financial services sector, following the publication of the report of the High-Level Group on Financial Supervision in the EU chaired by Jacques de Larosière on 25 February 2009 and the Commission Communication on Driving European Recovery of 4 March 2009.

Following consultation with members of the PricewaterhouseCoopers network of firms in the European Union, this response summarises the views of member firms who commented on this discussion document. “PricewaterhouseCoopers” refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

We are not responding to all of the detailed recommendations in the report which, if they are to be taken forward as specific proposals by the European Commission, will be subject to further public consultations later this year. However, in this letter we comment on what we consider to be some of the more significant issues.

In summary, our views are:

• We support a better global working environment for the financial services sector with improved co-operation and exchange of information. The proposals set out in the de Larosière report for Europe are an important step towards improving the global environment.

• We believe the Commission should adopt a careful approach to developing the proposals – analysing the reasons for current differences in regulatory approaches and consulting widely on any proposed EU measures, so as to avoid any unintended consequences.

• We encourage greater dialogue between accounting standard setters and regulators. However any proposals to improve accounting standards in light of the financial crisis should be looked at carefully to assess whether they aid transparency and comparability for investors.

We set out below our thoughts underpinning these views.
A better global working environment for financial services

The current financial crisis is truly global in scale. The crisis has illustrated that the financial markets are interconnected in ways not previously experienced or fully appreciated. It has also demonstrated that different approaches have been taken by national regulators on a range of issues.

We therefore support a better global working environment for the financial services markets with improved co-operation and exchange of information. This should help to reduce the overall level of risk in the system, while enhancing transparency and market confidence.

The de Larosière report recommends the creation of a European Systemic Risk Council (ESRC) as well as creating an integrated European System of Financial Supervision by transforming the existing Level 3 Committees, CESR, CEBS and CEIOPS, into ‘Authorities’ with certain key competencies granted to them.

We believe the creation of the ESRC and the enhancement of the Level 3 Committees would be an important step towards achieving greater coordination of supervisory approaches in Europe. However, those bodies must have real ‘authority’ and powers of persuasion if they are to achieve the market confidence necessary for them to be effective regulators. Issues that should be addressed include the funding of these bodies and the basis on which they can ensure Member State supervisors act appropriately. (One means of achieving this may be the ‘comply or explain’ approach – Member State regulators are required to comply with a commonly agreed position, or if not to justify and explain why not.)

There should be appropriate linkages between regulators and supervisors of the financial services industry and those responsible for dealing with the consequences of any financial services failure.

If an improved system of financial supervision can be implemented in Europe along the lines proposed in the de Larosière report, then it may provide a ‘blueprint’ for enhanced coordination on a global level, for example under the newly reconstituted Financial Stability Board announced by the leaders of the G20 countries.

A measured and consultative approach

We support the notion, as articulated in Recommendation 20 of the de Larosière report, that a more harmonised set of financial regulations should be conducive to restoring confidence in Europe’s financial services industry. However, we believe that it is essential to first gain a clearer understanding as to why differences in Member State application of the existing regulations occur in order to properly inform the debate as to how the regulations can be harmonised.

One of the greatest challenges when drafting European legislation - whether Directives, Regulations or Level 2 implementing measures - has been the compromises necessary to secure Member State agreement to a particular text. These compromises reflect not only underlying differences in corporate law and social and fiscal structures but also the evolution of financial services regulation in the various Member States driven by factors such as:

- Differing regulatory histories, for example financial services law has sometimes been crafted in response to previous crises whose impact may have been limited to certain markets;
- Varying exposure to different financial services products, or participants, impacting the relative competencies of the regulators and supervisors; and
- Differing expectations as to the role of regulators and supervisors within the totality of checks and balances in the financial services industry at the national level and resulting differences in their powers.
There may be a case for maintaining certain national exceptions or supplementary requirements. However it is important that, to the extent such national differences are accepted, these are publicly articulated, and the reasons for them properly explained, so that market participants have a clear understanding of the regulatory regime operating in any Member State.

There are two other aspects that we believe warrant careful attention as the Commission develops these proposals: (i) the risks of a adopting a ‘one size fits all’ solution across the entire financial services sector; and (ii) the risk of unintended consequences from any legislation.

We fully understand the focus of the de Larosière report on issues arising in the banking industry across the EU, given recent events, and agree that it is important that these are addressed promptly. However, we note that there is little ‘read-across’ to the insurance industry apart from the recommendation to adopt Solvency II. The design of the supervisory approaches and tools in Solvency II are not yet finalised with implementation some three or four years away. In our view, it is too soon to form a view on the effectiveness of the application of these new approaches and rules in the insurance sector or on any consequent changes to the regulatory and supervisory structures over insurance businesses that may be required.

Furthermore, we believe that there has been little, if any, suggestion that securities market regulation has suffered from the failings attributed to the banking sector.

We consider that, whilst joined-up regulation across the whole financial services industry is desirable to ensure that there are no ‘gaps’ and that there is equivalence in treatment of retail financial products on a cross-sectoral basis, it is important to allow the regulatory response to evolve according to the particular needs of any specific sector. Accordingly, we believe that consideration should be given to the wider implications across the whole financial services industry before adopting ‘one size fits all’ solutions.

Finally, while understanding the political imperative for timely responses to address the issues which have been identified, we suggest that an impact assessment should be made regarding any specific proposals in order to minimise the risk of unintended future consequences. The sheer complexity of the challenges involved demands that any detailed proposals should be subject to appropriate consultation.

**Accounting aspects**

Recommendation 4 in the report considers a number of aspects in relation to accounting, including that there should be a wider reflection on the application of fair value or mark-to-market principles and that accounting standards should not promote pro-cyclical behaviour.

While we do not believe that accounting standards can be blamed for causing the economic crisis, there may be room for improvements and therefore the standards and the process through which they are set have rightly been a focus for a number of the reviews of the crisis being conducted by governmental and regulatory authorities.

We encourage appropriate moves to improve prudential regulation so as to respond to recent events and the increasing co-operation between the accounting standard setters and regulators. However we also believe that the primary focus of accounting standards should continue to be the needs of investors and any changes to accounting standards must reflect this.

In our view the fair value model served to reveal quickly, to both investors and policy makers, deteriorating asset values and the associated economic implications. Fair value provides transparency to users of financial statements about current market conditions. However, the current financial crisis has challenged many of the underlying assumptions in the current standards, including the difficulty of the use of fair values in illiquid markets. We therefore support the joint agreement of the IASB and FASB to develop a new accounting standard for financial
instruments, and, without prejudging the outcomes, urge them to consider all perspectives in their deliberations including matters raised in the de Larosière report and by other bodies including the G20 and the Financial Stability Forum.

We support fully transparent disclosure in the notes to the financial statements of details of additional amounts of reserves required for regulatory purposes, including the basis on which those reserves are calculated. Any proposals to improve accounting standards for provisioning should be looked at very carefully to assess whether they aid transparency and comparability for investors.

We would be happy to discuss our views further with you. If you have any questions regarding this letter, please contact John Tattersall (+44 207 212 4689), Jens Roder (+45 3945 3238) or David Devlin (+353 1 792 6351).

Yours faithfully,

PricewaterhouseCoopers LLP