



**Hearing at the Economic and Monetary Affairs
Committee of the European Parliament
26 January 2010, Brussels**

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Chairman of the Committee of European Banking Supervisors

Dear President, Honorable Members,

I am pleased and honored to be invited to this hearing and thus to be able to continue the dialogue that you already established with my predecessors. The decisions taken by this Committee and your views are essential for CEBS'S work, as they underpin the goal of integrating European financial markets.

CEBS, and its members, are very mindful that effective accountability vis-à-vis European institutions is crucial to the status of our work, and to its effectiveness in promoting supervisory cooperation and convergence in supervisory practices.

Traditionally, CEBS'S activities were very much focused on regulatory issues. Initially, CEBS'S work was very much geared towards the implementation in the EU of Basel II. In this respect, we developed quite a number of guidelines on various issues which were intended to put flesh on the bones of the Capital Requirements Directive (CRD), the EU equivalent of Basel II.

The crisis has led to a very significant refocusing of CEBS'S work towards the analysis of risks and vulnerabilities facing the main EU cross-border banking groups. The coordination of supervisory

activities also became very important: CEBS started acting as a hub and platform in a network of EU supervisors on events such as those involving Madoff, Stanford and the Icelandic banks, and the recent event in Dubai. We also provided, at the request of the ECOFIN, possible answers to quite pressing questions such as how to treat for accounting purposes assets that suddenly became illiquid, and what is the quality of the disclosures of banks in the EU as the crisis evolves.

In my remarks now, I will focus on three main areas:

(i) On the new **European Financial Architecture** as it is envisaged by the European Commission and endorsed by the EU finance ministers.

(ii) On the **package of proposals** that have been issued by the Basel Committee on Banking Supervision (BCBS) and the European Commission (COM) with the goal of promoting a more resilient banking sector at a global and European level.

(iii) On **CEBS'S priorities for 2010**.

I. The new European Financial Architecture

CEBS has been very supportive of the conclusions of the De Larosière report and of the legislative package proposed by the European Commission. We contributed to the process and followed the political debate that led to some important adjustment in the decision making powers of the new authorities. The package agreed at the Council will provide the European Banking Authority (EBA) with significant tools and responsibilities, marking a major improvement with respect to the present situation.

Single rule book

The most crucial feature of the European Financial Architecture is that it enables the European Supervisory Authorities (ESAs) to **develop draft binding technical standards**, which after the endorsement by the EU Commission in the form of EU regulations or decisions, will be directly applicable in all EU Member States, without the need for national implementation. This is expected to contribute to **greater consistency in the application of EU financial services law**. CEBS supports these proposals and welcomes the ambition to develop a single EU financial rule book.

The scope of the binding technical standards will be set out in the **Omnibus directive**, which is to be adopted in the coming months. For the EBA, the mandate for developing binding technical standards is expected to **cover key areas of banking regulation**, which is going to be strongly reinforced - in line with the recommendations of the G20 and the Financial Stability Board – by the new package from the Basel Committee on Banking Supervision (BCBS), due to be finalized by the end of 2010. CEBS is best placed to take on the task of incorporating these changes into the EU regulatory framework in a manner that ensures their harmonized application across Europe.

We are fully committed to developing an EU common rule book over time; especially as this can contribute both to protecting citizens and consumers across Europe from the risks and costs of regulatory arbitrage, and to the most efficient functioning of the EU financial sector, which can, in turn, help enhance productivity and growth across the EU.

Given their regulatory and supervisory **expertise**, the ESAs should be given the central role in the production of the future binding

technical standards. The 3L3 Committees believe that, after the development of the draft binding technical standards by the ESAs, their endorsement by the EU Commission should be **limited to a review of the legality and consistency of these standards with EU law** - subject of course to the European Court of Justice having the final say, given its role in interpreting and applying the Treaties (Art. 220 EC Treaty).

In other words, we believe that the EU Commission's endorsement **should not include a power to alter or substitute** the technical substance of these standards. We would welcome a clarification to this effect in the final version of the ESA regulations.

Oversight of large cross border banks

The second important part of the new architecture will be the oversight of cross-border banks by means of colleges. CEBS is actively promoting the establishment of supervisory colleges for all major cross border banking groups and their effective functioning throughout Europe. We have colleges of supervisors established and functioning for more than 35 of the largest cross-border EU banking groups. As regards 2010, we will set extra **targets for the establishment of supervisory colleges** for an additional number of smaller cross-border European banking groups. Moreover, for colleges that already exist, we will set targets for **coordinated risk assessment under Pillar 2, in line with the provisions of the Capital requirements Directive (CRD)**. It is crucial that the new financial architecture provides effective underpinning for such work, stressing the **role of the EBA as a facilitator of colleges**, in order to achieve a consistent supervisory approach across Europe.

The **EBA should have a key role in providing an IT infrastructure** for the information exchange between supervisors



in colleges, and for providing **peer group information** about large financial institutions for supervisors

This infrastructure will also facilitate the EBA's task to develop periodic **assessments of the resilience of the EU banking sector, complementary to the macro-prudential analyses that will be developed by the European Systemic Risk Board.**

Such assessments are already conducted twice a year by CEBS. They combine an identification of system-wide risks and vulnerabilities for the EU banking sector, to which the ECB contributes, with a **bottom-up approach**, whereby colleges of supervisors of a sample of major EU cross-border banking groups deliver their own assessments of possible impacts on individual institutions.

As of 2011 when the EBA would be established, this could be an important corner-stone of the regular EBA assessment of market developments.

In addition, CEBS started last year a coordinated EU wide **stress testing exercise. For 2010, another exercise is scheduled, with involvement of the EU major banking groups. And also here**, a bottom-up approach is used and stress testing scenarios are being developed in close cooperation with the ECB and the EU Commission.

Cross Sector approach

Following on from the earlier point I made about the regulatory and supervisory expertise of the supervisors, we recognize the need of ensuring appropriate **sectoral expertise** is in place, given the **differing functioning, nature and risks** that are present in each of the three financial sectors.

Nevertheless, the financial crisis has made evident the need to also take into account the **cross-sectoral dimensions** of our regulatory work. To that effect, we have greatly intensified coordination with the other two Committees, CESR (Committee of European Securities Regulators) and CEIOPS (Committee of European Insurance and Occupational Pensions Supervisors).

In light of this, we welcome the plans to create a **Joint Committee** of the ESAs and stress its importance in the success of the new EU supervisory architecture. Not only will this formalize the current structures for 3L3 Committees' cooperation, but it will allow the identification of common risks in areas that have cross-sectoral relevance, and the formation of common supervisory responses to these risks, as and where required.

Smooth transition

Given that the EBA should be up and running on the 1st of January 2011 we need to ensure a **smooth transition** from CEBS to the European Banking Authority with increased tasks and responsibilities; 'uninterrupted continuation' is imperative. Thus, **NOW** is the right time to identify, prepare and set in motion the process for the transition from CEBS to the EBA. Concrete steps are being taken as of how to guarantee a smooth transition, thereby allowing the EBA to be operational **as of day one**, albeit certain tasks can only be implemented once the EBA is legally established.

As far as practically possible, CEBS is working closely with the other 3L3 Committees to ensure that cross sectoral transitory issues may be dealt with on a 3L3 basis. Furthermore, meetings with the European Commission have been arranged in order to ensure a smooth migration and the best possible results for the European Supervisory Authorities.

Working with the EBA vision in mind, we have already identified **specific priority areas** which will need due preparation and consideration, which are broadly based on the following: the building of a new IT Infrastructure, specifying the new EBA organizational structure, personnel and staff related issues, setting up the EBA member organisation, engagement of categories of stakeholders, regulations, revising the current 3L3 protocols, headquarter-considerations, planning for the EBA premises, continuation of utilities, insurance, telecoms, subscriptions etc, winding up of CEBS Secretariat Ltd and final accounts, budgeting system of the new EBA, etc.

CEBS will continue to identify further areas which will need preparation well in advance and will take the necessary steps to ensure a smooth transition to the EBA.

II. New proposals for reforming banking regulation

The second topic I would like to address today relates to the new proposals for reforming banking regulation

Solutions in bank regulation should be global. In December 2009 the BCBS – following the recommendations from the G20 leaders and the FSB - has issued concrete proposals that are expected to be finalized by the end of this year and introduced by the end of 2012, if this turns out to be consistent with the pace of the economic recovery at the global level. The proposals envisage a tighter definition of capital, enhancements to the risk coverage of capital regulations – in particular in the areas of structured finance most affected by the crisis -, the introduction of limits to leverage, countercyclical capital buffers and new standards for liquidity risk. The impact of the new regulation will be assessed by a comprehensive quantitative impact study (QIS). CEBS will conduct a

parallel **EU QIS**, relying on the same methodology, but extending the sample to include a number of other institutions to which the CRD applies (e.g. small and domestic institutions and investment firms) and institutions from countries which are not represented in the BCBS. It will allow also the consideration of the differential impact of alternative definitions of the rules and will include questions to address EU specificities. First findings are expected by the end of June or early July.

The QIS will provide the information to get the overall calibration right, providing positive incentives to business models that ensure a sound financing of the real economy and discouraging complex and risky activities. The analysis will also help defining transitional periods for the phasing in of the new rules – e.g., through grandfathering clauses.

CRD amendments

Let me now briefly mention a few additional areas of regulatory development where CEBS'S contribution has been requested.

As part of the review of the **definition of own funds**, CEBS has published last December its guidelines for the convergence of supervisory practices with regard to hybrid instruments. The guidelines will be applied from the end of the current year together with the respective CRD amendments. CEBS stands ready to revisit its guidelines to further align them with the expected evolutions in the global regulatory framework with regard to the definition of capital instruments.

CEBS has also published its consultation paper on **Core Tier 1** (Article 57a), which contains eligibility criteria for inclusion of capital instruments in original own funds without limits. These criteria are broadly consistent with the principles that the BCBS has adopted for instruments to be classified as common equity for regulatory capital

purposes. CEBS is prepared to take into account these evolutions in its final guidelines. When elaborating these criteria, CEBS has taken into account the specificities of non-joint stock companies

In 2009 CEBS has developed work on pro-cyclicality and accounting. CEBS'S proposal to address the pro-cyclicality of minimum capital requirements has been included in the consultation paper of the Basel Committee. Moreover, we issued an interim report which assessed: i) the countercyclical nature of some accounting impairment approaches under consideration by the IASB, and ii) dynamic provisioning and reserving approaches that are being considered or in use by prudential supervisors.

CEBS'S advice has also been requested in **assessing the effectiveness of a minimum retention requirement for securitisation**. Retention is only one of a package of measures aimed at better aligning the interests of originators and investors in the securitisation market; it is not a panacea and many concerns may be better addressed by other measures, such as enhancing disclosure requirements. CEBS advised that all four retention options proposed by the Commission be maintained and that the retention number be kept at 5% since a significant increase could have the unwanted consequence of undermining the ability of firms to achieve significant risk transfer. In the US a similar initiative has been put forward, with a 5% retention requirement, to encourage originators to make loans of better quality.

Remuneration

On remuneration CEBS has - in close cooperation with other international institutions working on this area (like the FSB and BCBS) - published principles that banks should follow in order **not to encourage or reward excessive risk-taking**. The Commission's proposed regulation (CRD III) on this area builds on

the grounds set by CEBS. We are now mandated to move further and develop guidelines [in the first quarter of 2010] in order to align supervisory assessments and to assist firms in complying with the principles. The development of these guidelines will benefit from a two-stage implementation study that CEBS had already started; the first stage—understanding how the principles have been applied in national regulations - has been completed; currently we are gathering information from our members on how the banking institutions have implemented the principles.

III. CEBS'S priorities for 2010

For 2010, the highest priorities for us will continue to be: i) contributing to an effective supervisory and regulatory response to the financial crisis, ii) projects connected to the upcoming changes in Basel II and CRD as well as iii) to the anticipated changeover from CEBS to the EBA – a challenge that should be met by end of 2010.

In the field of regulatory responses to the financial crisis at the end of 2009, we have launched consultations on a number of guidelines, which will be finalized in the first half of 2010. Draft guidelines on the **operational functioning of colleges, on concentration risk, on stress testing, on core Tier 1 (article 57 (a) of the CRD), on the management of operational risk in market related activities** are part of the work we have started in 2009 and give clear messages of CEBS determination to ensure further convergence of the supervisory practices around Europe.

Just recently, the consultation on our draft **guidelines on disclosure** has been completed. The guidelines are based on four successive assessments that CEBS has undertaken made of

progress made by banks in improving their disclosures and bringing them in line with CEBS'S good practices published in June 2008.

CEBS contributed to the work of the Commission to develop an EU Framework for **Cross-Border Crisis Management in the Banking Sector**.

CEBS fully supports the objective of the proposed framework which is to ensure that all national supervisors in the EU have adequate common tools to identify, at an early stage, problems in banks and to intervene to ensure an orderly resolution of cross-border groups whose foreign subsidiaries may be subject to different supervisory and legal regimes.

In its response to the Commission, CEBS has conveyed several messages:

- i) A series of tools has been identified that should be part of a **single intervention and resolution toolbox** available to the competent authorities in each Member State.
- ii) **Specific conditions** have to be met for the use of these tools, in particular when they have a significant impact on the rights of shareholders; but flexibility should be kept in supervisors' interventions and automatic triggers should be avoided;
- iii) An **enhanced cooperation framework** is needed; home and host authorities should consult each other before taking intervention and resolution measures and consider joint measures which would be to the benefit of the group as a whole.
- iv) **Deposit Guarantee Schemes should be able to contribute to the costs of resolution measures**. Another solution to optimize the role of DGS would be to create **solidarity** among them via a **multilateral re-insurance mechanism** whereby national DGSs could support each other when needed.

v) Amendments to **insolvency law** would be mostly needed in relation to cross-border banks.

vi) Within the new EU financial supervision architecture, the EBA will exercise a coordination function in crisis situation and will be able to adopt decisions in emergency situations requiring the national competent authorities to take the necessary actions. This will further increase the coordination mechanisms at the EU level.

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Thank you for giving me the opportunity to speak and I stand ready to discuss any issues or comments that you may have.