

28 June 2010

Public hearing on CEBS's draft Guidelines for the joint assessment of the elements covered by the supervisory review and evaluation process and the joint decision regarding the capital adequacy of cross-border groups (CP39)

Note of the meeting

London, 3 June 2010

The Committee of European Banking Supervisors (CEBS) held a public hearing on 3 June 2010 to present its draft "Guidelines for the Joint Assessment of the Elements Covered by the Supervisory Review and Evaluation Process and the Joint Decision Regarding the Capital Adequacy of Cross-Border Groups (CP39)". The hearing was chaired by Jukka Vesala (Chair of the CEBS Groupe de Contact - GdC) supported by Sebastiano Laviola (Chair of the CEBS Subgroup on Operational Networks - SON).

Around 10 representatives from individual institutions, industry associations, consultancy agencies and journalists attended the hearing. There was constructive debate during the two hour session within the context of broad support for the new guidelines as a step towards further convergence of supervisory practices, which led to several important points being raised for consideration by CEBS.

1. Background and introductory remarks

On 7 April 2010, CEBS published, for consultation, its draft "Guidelines for the Joint Assessment of the Elements Covered by the Supervisory Review and Evaluation Process and the Joint Decision Regarding the Capital Adequacy of Cross-Border Groups (CP39)"¹. The draft guidelines respond to Article 129.3 of the revised Capital Requirements Directive (CRD)², which stipulates that the consolidating and the EEA host supervisors of an EEA cross-border banking group do everything within their power to reach a joint decision on the application of the Pillar 2 provisions related to the Internal Capital Adequacy Assessment Process (ICAAP) and to the Supervisory Review and Evaluation Process (SREP).

¹ See: <http://www.c-eps.org/documents/Publications/Consultation-papers/2010/CP39/CP39.aspx>

² Capital Requirements Directive (CRD) is a technical expression which comprises Directive 2006/48/EC and Directive 2006/49/EC. Please note that in general references to "Directive 2006/48/EC" and "Directive 2006/49/EC", or "CRD", refer to the versions of the Directives as amended in May 2009. The amending Directive can be found under: <http://www.europarl.europa.eu/sides/getDoc.do?type=TA&reference=P6-TA-2009-0367&language=EN&ring=A6-2009-0139>

The joint decision should cover the adequacy of the consolidated level of own funds held by the group and its entities with respect to their financial situation and risk profile, as well as the required level of own funds above the regulatory minimum to be applied to each entity within the group, or at the consolidated level, where needed. The revised CRD also requires CEBS to elaborate guidelines to facilitate the implementation of these provisions and to promote convergence of supervisory practices with regard to the joint decision process.

In his introductory remarks, the Chair of the GdC stressed that although the draft guidelines might seem to be mainly of interest to supervisors, nevertheless, as the focus of the draft guidelines is on the application of the Supervisory Review and Evaluation Process for the cross-border banking groups, the guidelines should offer enough insights for the industry in terms of the direction the supervisory cooperation process is taking.

The Chair of the GdC stressed that the CRD requires that there be a joint decision on capital adequacy but, to reach it, CEBS believes that a joint assessment should also be conducted in order that there be a shared understanding of the risks and vulnerabilities of an institution at the consolidated and individual entity level, which should enable college members to make a more informed decision on the level of own funds both at the consolidated and solo levels as required by Article 129 (3) of the CRD.

In his presentation of the draft guidelines, the Chair of the GdC drew participants' attention to the proposed elements for the joint assessment as well as to the proposed scoring methodologies, and requested that the representatives of the industry pay special attention to these elements when providing comments to the guidelines, as it is important for CEBS to know whether the assessment of proposed elements will be sufficient, in the view of the industry, to furnish an adequate overview of the risk and control profile of an institution (both at the consolidated and individual entity level).

2. Participants' remarks

a. Involvement of non-EEA supervisors

One participant wondered how the participation of non-EEA supervisory authorities would work in practice. The Chair of the GdC and the Chair of SON pointed out that the draft guidelines were flexible enough to allow the consolidating supervisor to involve non-EEA supervisors in the joint assessment process where the non-EEA entities are relevant to the overall group's risk profile, although, only EEA supervisory authorities are bound by the joint decision required by the CRD. This legislative constraint is specific to the EEA colleges, but, with respect to the assessment section, the Basel Committee's work on colleges³ also encourages collaborative work in risk assessment, in order that a shared understanding of the banking group's risk profile might be reached. In practice, non-EEA supervisory authorities are already participating in colleges of supervisors where the home and hosts' supervisory assessments are already being shared and discussed.

³ See Basel Committee on Banking Supervision Consultative document on "Good Practice Principles on Supervisory Colleges", March 2010, <http://www.bis.org/publ/bcbs170.pdf>

b. Involvement of the institution in the joint assessment and decision process

Several participants stressed that, as part of Pillar 2 for cross-border groups, the joint assessment and decision process should not disregard the importance of dialogue with the supervised institutions. One participant suggested sharing the templates summarising the joint assessment with the supervised group and another proposed that the consolidating supervisor and the parent company channel all the communication flows within the joint assessment and decision process.

CEBS acknowledged that the process of the joint assessment should involve close interaction with the banking group in question. In the context of the joint assessment and decision process, one could identify at least the following stages, when such institutional supervisory interaction could take place:

- submission of ICAAP reports, if and where requested, by all entities of the group subject to the ICAAP reporting requirements;
- dialogue between individual entities and the respective supervisors, which might be needed in the course of preparing the supervisory assessment of an individual entity;
- coordinated dialogue between the college members and group functions, which might be needed in order to assess centralised functions of the group rendering services to individual entities (e.g. risk management function, risk measurement, economic capital modelling, capital planning, governance issues and stress testing);
- communication of the results of the joint assessment and decision to the group and, where relevant, to the other entities, subject to the joint assessment and decision process;
- dialogue between the group, its entities, and relevant supervisors to discuss the results of the assessment, which could be done both at the consolidated level, and, where appropriate, at the level of individual entities.

Further to sharing the joint assessment and decision results plus key findings (including general outcomes in terms of capital decisions and key deficiencies to be addressed by the institutions) with the supervised institutions, CEBS will analyse ways of making this interaction more explicit in CP39 as well as the feasibility of sharing the joint assessment summary templates with the supervised institutions at the consolidated and, where appropriate, at the individual entity level. It was pointed out that, given that host supervisors have legal responsibilities regarding the solvency of the legal entities they supervise, they cannot give up direct dialogue with the supervised institutions in favour of the consolidating supervisor and parent company acting as single entry points.

c. Role of the consolidating supervisor in the joint assessment and decision process

One participant was of the view that the current wording of CP39 suggests a purely bottom-up approach to the joint assessment and decision process where the group perspective is replaced by the summation of the assessments of individual entities. CEBS clarified made it clear that the consolidating supervisor is entrusted with providing its assessment from the consolidated point of view as an important input into the process and that the consolidating supervisor is also entrusted with a central role as the coordinator of the process. In CEBS's view, both the so called "bottom-up" approach referred by a participant and the "top-down" approach, where the consolidating supervisor is leading the assessment and seeks input from the involved host supervisors, are possible within the context of the draft guidelines. However, it is essential that the input coming from the host supervisors on the assessment of the respective entities is clearly taken into account in the overall assessment. CEBS is committed to reviewing the wording of the draft guidelines in order to make this aspect clearer where necessary.

d. Different weights for host supervisor's contributions

One participant asked whether host supervisor's inputs to the joint assessment and decision process would be weighted. The Chair of the GdC and the Chair of SON made it clear that the draft guidelines were designed with the principle of proportionality and relevance in mind and propose a closer involvement of the core college members, where appropriate, and, that the joint assessment focus on the material risks, vulnerabilities and material entities.

e. Time lags between input data and outcome of the joint decision

One participant asked how to tackle the time lags between the reception of supervisory data by individual supervisors and how to base the joint decision on the most updated information available. The Chair of the GdC and the Chair of SON pointed out that the guidelines advocate the coordination, to the maximum extent possible, of ICAAP reports where requested; the ongoing updating of the information throughout the joint assessment process where needed and the joint assessment have a forward looking perspective. CEBS would like the joint assessment and decision process to be regarded as a continuous college activity based on the constant stream of supervisory information obtained from the ongoing off- and on-site activities rather than a one-off event taking place once a year.

f. Ensuring consistent approaches across colleges

One participant wondered if the common templates and common scoring scales introduced in the draft guidelines were enough by themselves to ensure consistent use across colleges. In that respect, he welcomed the presence of CEBS as an observer and suggested a European common framework for risk assessment. CEBS acknowledged that these guidelines were a first step towards a more harmonised framework in the future, to which the upcoming EBA could contribute by means of the single rulebook and by means of the oversight of supervisory colleges. It was also mentioned that the staff of the CEBS Secretariat are already participating as observers in the college of supervisors and promoting the convergence of supervisory approaches. Furthermore, the methodologies proposed in the draft guidelines are also used for the purposes of

the CEBS regular micro-prudential assessment of risks and vulnerabilities facing the EU banking sector, the results of which are reported to the EU institutions.

g. Coordination of supervisory stress tests

Some participants raised a concern over the stress testing in the context of cross-border banking groups, pointing out, that in such cases, stress tests should be done at the consolidated group level rather than at the level of individual legal entities. The Chair of the GdC recalled the same discussion at the public hearing on CEBS's revised Guidelines for Stress Testing⁴ and confirmed that CEBS expects cross-border institutions to implement these guidelines and set up stress testing programmes covering the consolidated level and, where applicable, material entities and/or business lines subject to the principle of proportionality and relevance.

Following the principles of the home-host supervisory cooperation elaborated in the CEBS Guidelines for the Operational Functioning of Colleges⁵, colleges of supervisors play an essential role in the coordination of supervisory activities, including stress testing. In the context of the colleges of supervisors, home and host supervisors should assess the stress tests performed by a cross-border operating group as part of their stress testing programmes in order to ensure that all material risks to the group as a whole and all its material entities (subsidiaries) are adequately captured.

The Chair of the GdC and Chair of SON also emphasised that, in the case of a cross-border banking group, any discussion on institution specific capital buffers required to mitigate the outcome of stress tests should take place in the course of a joint decision on consolidated and solo capital adequacy, as required by Article 129(3) of the CRD, and be conducted in the context of the college of supervisors.

h. Content of the joint decision

One participant detected a divergence between the general tone of the draft guidelines, which imply that the joint decision should cover the capital adequacy of the group and its entities, and the exact wording of Guideline 23, which only mentions explicitly the capital adequacy at the consolidated level. The Chair of the GdC and the Chair of SON pointed out that Guideline 23 is meant to cover capital adequacy at both the consolidated and individual levels and that it would be reworded accordingly.

At the request of one participant, the Chair of the GdC and the Chair of SON clarified stated that capital add-ons should be covered with regulatory capital, as required by Article 136.2 of the CRD and that Tier 1 capital is suggested because of its loss absorbency features in going concerns.

3. Next steps

⁴ See notes from the 10 March 2010 public hearing: http://www.c-eb.org/documents/Publications/Consultation-papers/2009/CP32/CP32_Summary.aspx

⁵ <http://www.c-eb.org/documents/Publications/Standards---Guidelines/2010/Colleges/CollegeGuidelines.aspx>

Attendees at the hearing were encouraged to provide their written comments to the draft guidelines by 9 July 2010. All comments received will be published on CEBS's website unless respondents request otherwise. The final version of the document, taking into account the results of the public consultation, is expected to be ready by the end of 2010 and will be published on the CEBS website.