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RESTRUCTURING THE GLOBAL FINANCIAL ARCHITECTURE

- THE ROAD AHEAD –

REGULATION AND SUPERVISION IN EUROPE: NEXT STEPS

Towards a New Architecture for European Banking Supervision

Ladies and Gentlemen,

Let me take you back a few years. 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. Since then, a lot has happened. The crisis has led to a tremendous refocusing of CEBS's work. Besides regulation, the coordination of supervisory activities also became important. It already seems a long time ago, but, in effect, it was just a year ago when CEBS was acting as a hub and platform in a network of EU supervisors on events such as those involving Madoff, Stanford and the Icelandic banks. 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.

Last but not least, the financial crisis has shown how important it is to continuously take into account the **cross-sectoral dimensions**; therefore. 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).

But this is looking back, whereas I would now like to focus more on the future.

Of course, we all know the legislative proposals that are now being negotiated in the European Council and that will subsequently be discussed in the European Parliament.

I would like to select two important and concrete topics for the future architecture of European Banking Supervision,namely:

1) A common EU Rule Book for banking regulation.

2) The enhanced oversight on cross-border banks.

A common EU Rule book

One of the lessons learned from the crisis is that the bank regulatory regime, built around Basel II, needs to be improved.

Solutions in bank regulation should be global. The Financial Stability Board (FSB) and subsequently the Basel Committee on Banking Supervision (BCBS) have worked intensively on global regulatory responses to the crisis. Concrete proposals are expected to be finalised by the end of 2010 and should be introduced by the end of 2012. Quite a number of changes will come our way. I will only mention the following:

- Strengthening the treatment for certain securitisations in Pillar 1 (minimum capital requirements), by introducing higher risk weights for re-securitisation exposures (so-called CDOs of ABS) to better reflect the risk inherent in these products
- Strengthening the quality of capital.
- Building capital buffers that could be drawn down in periods of stress.
- Introducing a leverage ratio as a backstop to Basel II.

- Introducing higher capital requirements to capture the credit risk of complex trading activities.
- Managing risk concentrations.
- Strengthening disclosure requirements for securitisations, off-balance sheet exposures and trading activities.
- Introducing rules on Liquidity risk and liquidity risk management.

The full impact on the new regulations is still unknown. Therefore, CEBS will undertake, in parallel, with Basel **a QIS on the new proposals in the first half of 2010**. Undoubtedly, these changes will materially impact the EU rule book on bank regulation, since they will result in a **revised regulatory framework in the EU**. A key feature here are the binding technical standards, to be developed by the future European Banking Authority (EBA), as directly enforceable EU regulations. The EBA is expected to be mandated with the development of them in relation to areas concerned with banking regulation, which are key to achieving a harmonized application of the CRD in Europe. The EU Commission will propose these areas, and the Council and Parliament will give their agreement to them.

Representative examples here are standards for supervisory reporting and standards for joint assessments under Pillar 2. What is the novel here is that these standards will be **directly applicable** in all EU Member States after they have been agreed upon, without the need for a national transposition. They will be developed by the EBA which has the technical expertise to do so, and will be endorsed by the EU Commission.

Are these standards sufficient to achieve a uniform EU rule book? We believe that, in addition, to these technical standards, the current EU level 1 and 2 legislation also needs to change. We specifically see a need to **delete the national discretions and options** we still have in the CRD and that over time the CRD evolve into a regulation based upon **maximum harmonization**, without gold-plating by individual Member States.

Oversight of cross-border groups

The second important part of the new architecture will be the oversight of cross-border banks by means of colleges. CEBS strongly supports this reinforced oversight of **cross-border banking groups**. We are actively promoting the establishment of supervisory colleges for all major large financial institutions and their effective functioning throughout Europe. In this context, we have agreed that colleges of supervisors will be established and up and running for 36 of the largest cross-border EU banking groups. As regards 2010, we intend to set extra **targets for the establishment of supervisory colleges** for an additional 10 to 20 cross-border European banking groups. Moreover, for colleges that already exist, we will set targets for **coordinated planning and assessment under Pillar 2**. This will be done, in anticipation of new guidelines on the operational functioning of colleges of large cross-border groups and on coordinated risk assessment that will come into force by the end of 2010.

By these means, we will surely contribute to an increased oversight of the cross-border groups in Europe. Let me just make clear that here also our approach is primarily global. One bank should in principle have one college, which could meet in different operational settings. Also important here, is the future **role of the EBA as a facilitator of colleges**, which builds upon current activities. As you probably know, it is envisaged that the future EBA will have an official observer status in colleges. Please note in this respect that CEBS Secretariat members are already now being invited to many college meetings, which is regarded as beneficial both to the CEBS's people involved and the supervisors participating in the college.

We also see a clear added value for the **EBA in providing an IT infrastructure** for the information exchange between supervisors in colleges, and for the EBA in providing **peer group information** about large financial institutions for supervisors that are active in the supervision of cross-border groups. By providing this information, home supervisors can make more meaningful comparisons in their off-site supervision for these banks.

But more is being done for an increased oversight of the cross-border groups via colleges.

The future EBA will continue to perform **EU-wide risk assessments** on the vulnerabilities of the EU banking system and will also have a role in testing the resilience of the EU banking sector by means of **stress tests**. This work will be done in close cooperation with the European Systemic Risk Board (ESRB), which will provide the necessary **macro-prudential input**. The EBA will subsequently perform these risk assessments and stress tests via a **bottom-up approach**, whereby the largest cross-border banking groups will be the primary focus.

This will continuously provide valuable information which will contribute to an increased oversight of these large financial institutions (LFI). And in case home and host supervisors within a college are not able to **settle a disagreement** on the way forward in a cross- border situation, then the EBA could step in to keep the college-process functioning and provide the supervised LFI with a clear decision.

So, in summary, both the common EU rule book and the increased oversight of large financial institutions by means of colleges are very **important and concrete next steps in building a new Architecture for EU Banking Supervision**.

You will see the first **technical standard by the end of 2012**. So the future isn't that far away. We have already started to build it, in anticipation of EBA's future tasks.

Thank you for your attention.