ELEC

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Challenges for supervisors in responding to the financial crisis

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Ladies and Gentlemen,

I am honoured to be invited to ELEC and discuss the important questions around financial regulation and supervision in Europe.

In times like this, when there is a serious financial crisis still unfolding, supervisors' role is questionable. A current topic for discussion in many fora is the organisation of supervision.

CEBS welcomes the Commission's initiative to analyse possibilities to develop the present framework for financial regulation and supervision in Europe. A first preliminary discussion of the de Larosière report was held during the CEBS plenary meeting this week. CEBS stands ready to participate in the dialogue with EU institutions during spring in their formulation of changes for the future.

The organisational set-up of supervision in Europe, both on a national basis and on an EU level is a highly political issue.

CEBS has continuously focused on an evolutionary approach to supervision, building upon the current structures in place in Europe.

To achieve convergence among European supervisors there is no substitute for hard work. Build the EU supervisory culture and support the national supervisors' work on cooperation at the EU level. Develop and make efficient the work of supervisory colleges and finally make sure that supervisory authorities have enough resources for all the challenging work they have on their plates. The evolutionary approach will gradually deliver convergence among European Supervisors and efficiency in the cooperation of supervision of cross border banks.

The financial crisis has showed that there is a need to strengthen convergence in the application of prudential standards and a need to achieve more consistent supervisory practises.

But before I continue, I would like to give you some information about the Committee of European Banking Supervisors.

We have been up and running the last 5 years. Our legal status is that of a private company under UK law.

We have 27 members, both supervisors and central banks from each EU country. We have also participants from the EEA countries, the EU Commission, the ECB and the BSC- around 55 people are at our table. In fact, we reputedly have one of the largest meeting tables in London.

Our mandate is to give the Commission advice on regulatory issues and to promote convergence and cooperation among banking supervisors. We have no responsibility for the supervision of individual banks.

We have an organisation with three main expert groups dealing with

- Convergence of supervisory practices and supervisory cooperation
- Development of prudential regulation
- Reporting, transparency and valuation

In total our expert groups keep busy more than 120 people.

During 2008 we had more than 100 meetings organised by the CEBS main committee and its expert groups. All meetings held mainly at our office in London.

During the first 5 years we have given the EU Commission advice on many different legislative issues and issued our own guidelines.

Today it is a full time job being Chair of CEBS. I am meeting with the different EU Committees at least twice a month. I am regularly called upon hearings at the EU Parliament, I have meetings at least twice a month with the Chairs of CESR and CEIOPS and I meet regularly with the Chair of the Banking Supervision Committee under the ECB. I should not forget to mention that we have extensive consultations with the banking industry.

Why am I telling you all this? – Well, because it shows that even though CEBS is not an EU institution in a technical sense, the work we have put in so far and our contribution to deliver convergence in Europe is substantial. We have built the cooperation among EU banking supervisors on a very solid ground. It may have taken a few years but on the other hand there is now, after 5 years of hard work, a very broad shared understanding among banking supervisors on both financial regulation and supervision. There is more to do, but the platform is established.

The European Union is a long term project and sometimes we are able to take big steps while sometimes only small steps are possible. Unfortunately there are no quick fixes in an organisation constituted by 27 countries. We have to make sure that there is a good understanding on what is sound and prudent regulation and supervision. We are building a supervisory culture, which is perhaps the most important building block for the good understanding and cooperation among supervisors.

The present crisis has clearly indicated that there are obstacles in the present framework when it comes to handling a crisis of a cross border bank.

First, in the EU we have to make sure that there is legislation framework in place that gives supervisors the necessary tools to handle financial markets both under normal conditions and under stressful situations like the one we are currently experiencing. CEBS has provided the EU Commission with advice on how to make the EU banking regulation more consistent and harmonised. As you may know, we have asked for early changes in the areas of liquidity risk management, the large exposures regime and the definition of capital.

Last year CEBS urged the EU Commission to eliminate 80% of all the national discretions and options presently available in the Capital Requirements Directive. All these efforts by CEBS will surely help to achieve a more uniform EU Directive. What also helps is a more harmonised implementation of the primary EU legislation. CEBS is playing a great role here in issuing guidelines in order to put more flesh on the bones of the CRD.

It's also obvious today that the present directives don't give supervisors enough power to intervene early in a prompt and converged fashion. As there are around 40 major cross border banking groups in Europe we have to make sure that supervisors, when needed, have a legal basis to take action in a converged way. The present accusations concerning alleged protectionism is one example where supervisory decisions are seen as being protectionist when they are taken in one country on the basis of national legislation but affecting banks in other countries negatively.

CEBS has this week provided the Commission with a stock take on the present early intervention tools and supervisory powers that are in force in member countries. The view we have delivered to the Commission is rather split. The Commission will issue a white paper later on this year and the overall aim is to achieve more convergence also in this area.

A second issue of non convergence and outside the brief of supervisors is deposit insurance. There are still differences in the national deposit insurance schemes that may create problems in a crisis situation and raise level playing field under normal conditions.

Third, on the lender of last resort function and the co operation with central banks. Cooperation between central banks, supervisors and ministries of finance has been developed over the past few years. The MoU on crisis management signed last year is a step forward even if there seems to be limits on national authorities' resources available to implement the MoU. In several countries there are also obstacles in national legislation as cross border banking groups are not able to freely transfer collateral across borders to meet the liquidity needs in the group as a whole.

A forth issue that may be even more problematic is the key for burden sharing between the states involved when money is required for an orderly resolution in a cross-border situation.

So if we aim to build European convergence we have to look at the whole picture. There is a clear need to reach more convergence in legislation, supervision and deposit insurance schemes. We also have to find solutions for the lender of last resort function and rules for burden sharing between countries.

Now I will turn to the CEBS work on convergence and the issues we foresee as important on financial regulation.

Which tools does CEBS have to deliver more convergence in supervisory practices?

Differences in supervisory practices are noticeable in the supervision of cross border EU banks. Given the importance of these banks for financial stability and the potential impact of an unlevel playing field in Europe it is important to strive towards sufficiently consistent supervisory approaches.

Supervisory culture

CEBS is now playing an important role in promoting convergence in supervisory practices in order to minimize regulatory burden and compliance costs for cross border banks.

To cope with challenges in different supervisory practices, CEBS has continuously worked on fostering a common supervisory culture in Europe. It is being promoted by organising a lot of common training courses amongst EU supervisors, encouraging staff exchanges, inviting more people working in CEBS' structures and facilitating intense information exchange between supervisors, where appropriate.

Common toolkit

The existing CRD already contains strong language requiring supervisors of a banking group to cooperate closely with each other and engage in information exchange (Art. 132), under the coordination of the consolidating supervisor. The currently proposed amendments to the CRD further underline this need by providing a legal underpinning for colleges of supervisors.

CEBS welcomes and strongly supports this initiative by the Commission. CEBS has been working hard within the so-called Lamfalussy Level 3, but we believe that our work would be better supported with a clearer legal basis.

A good example of where close multilateral cross-border cooperation between supervisory authorities has recently taken place in the approval and validation process for allowing firms to use advanced models for credit (IRB) and operational (AMA) risks (Pillar 1 models). While this form of cooperation is directly required by the legislative framework of the CRD, it proved to be an efficient ice-breaker for intensification of cross-border supervisory cooperation more generally. In order to facilitate the smooth functioning, CEBS has issued guidelines on how to validate IRB and AMA models.

The collegial approach to the approval of Pillar 1 models was also very well received by the industry. The evidence of an effective coordination and cooperation between supervisory authorities has stimulated several industry representatives to request an extended application of the joint decision making foreseen in article 129(2) of the CRD to include Pillar 2 and 3 matters also.

On a number of topics CEBS has issued guidelines to supervisors. For example

- liquidity risk supervision,

- passporting
- supervisory review and evaluation process

All those guidelines form the platform for the joint supervisory approaches.

Colleges

Over the last decade there has been a clear trend towards more cross border banking, both through subsidiaries and branches. The European legislation has facilitated for banks to integrate activities within the EU and there are now around 40 major banks with significant cross border activity. Cross border banking has contributed to increased competition, and provided a stimulus to economic growth in member states. However, it is more and more evident that the EU banking directives were decided when cross border banking still was on a very light scale. When the directives where drawn up it was not foreseen that we nowadays in some countries have branches of foreign banks that are systemically important and that many cross border banking groups nowadays have centralised treasury functions and liquidity management. This is something that makes supervision more complicated, not least for the host supervisors. Colleges can play an important role in bridging information gaps and spreading knowledge in cases where the host or home authority on a stand alone basis doesn't have enough insight or competence.

CEBS has been promoting the establishment of colleges of supervisors since 2006. In our work with the implementation of the CRD we developed the concept of colleges and we have issued several papers with guidance to our members on how to do this in a practical way. Nowadays you find the college approach mentioned also on a global level in the FSF and G20 recommendations.

A "college of supervisors" in our view is a tool to coordinate the practical supervision of a cross border group. Topics could be identification of the main risks facing the banking group, the strategic direction, its risk management framework, and the supervisory work plan for the group as a whole and/or parts thereof etcetera.

There is a special role for the home country supervisor in establishing such a college and in making it workable. A recent survey amongst CEBS members showed that home country supervisors have stepped up their efforts in establishing such colleges and initiating regular college meetings. For most of the biggest EU banks, colleges are in place.

The big added value of the college approach is that the supervisory authorities that participate in the colleges on a stand alone basis can take decisions on a more informed basis and that there is now an extra opportunity to coordinate supervisory activities. But it is not a guarantee for getting the same decisions by all supervisors, since the college of supervisors does not change the division of responsibilities between home and host supervisors. Every supervisor and Member State retains its own decision making powers in respect of that part of the group to which it has given a license to operate.

In the discussion about the need to improve the present organisation of supervisory functions in Europe the college model has been criticized for not facilitating the members to take decisions especially not in a crisis situation.

Here I would like to emphasise again that a college is a supervisory tool to facilitate cooperation and information exchange. As long as supervision is based on national legislation a college can never be given full decision making power. This means also that in a crisis situation a college will not be able to take decisions on sanctions or resolution. Those decisions have always to be taken by the respective home and host authorities. A college will in a crisis situation continue to work on co operation and information sharing and in some cases also provide the decision taking authorities with proposals for actions and decisions to take.

Having said all this, my message is that colleges are not a substitute for a more centralised co ordination of supervision in Europe; they are a supplement. Colleges are a tool for supervisors to make sure that cooperation and information sharing works smoothly between home and host authorities.

CEBS task during 2009 is to make sure that our members are establishing colleges for the around 40 largest cross border banking groups. We will monitor that supervisory agreements comes into place and that the planning of joint assessments and activities takes place.

Which are the tools to contribute to a more harmonised regulatory implementation?

CEBS plays an increasing role in strengthening the consistent implementation of the CRD and CEBS' guidelines across Europe. More specifically, CEBS has introduced three dedicated tools to assist this.

Peer Review Mechanism

All 27 EU supervisory authorities have signed up to perform peer reviews to see whether their national legal frameworks and their supervisory practices are in line with that which has been agreed upon as a common EU approach. To this end, we have set up a Review Panel and are now testing the approach taken, to see whether it is sufficiently robust and specific. Such peer reviews will become part of the regular activities of CEBS and you will be able to see and comment on the outcomes of their analyses.

Supervisory Disclosure framework

Secondly, we have a common supervisory disclosure framework which is accessible to the public via our website. Here the 27 supervisory authorities show how – from a regulatory perspective – in their countries the CRD provisions have been implemented and how the CEBS guidelines are applied. It is a powerful tool, especially for EU cross-border banks, to see how the CRD has been implemented in the different Member States, with their different legal structures, and to signal possible differences between Member States.

Mediation mechanism

And last but not least, supervisors within Europe have agreed to participate in a mediation mechanism in case disputes between supervisors in the exercise of their duties arise. This could, for example, be about differences of opinion on necessary remedial actions between supervisory authorities and Member States in the exercise of their respective responsibilities with regard to a cross border bank. It could also address a level playing field issue between banks in different EU Member States.

New regulation in response to the crisis.

Finally I would like to highlight a few more topics that are on our agenda. Some work started already before the crisis but some of our actions are taken in response to the financial crisis and as a follow up on the Ecofin and G20 roadmaps.

-Liquidity risk management is the first one. The work on improved regulation and supervision started already before the crisis but has been intensified. We have issued advice to the Commission in this area but are now also improving supervisory practices.

- Other areas are transparency and valuation. We have already done a lot in this area in order to promote better transparency and valuation and thus give a better understanding of risk exposures. We are at the moment assessing the result of banks financial statements at year end and we will discuss if there is a need for more regulation in this area in order to reach the desirable level of disclosure.

- A third issue is remuneration schemes. CEBS will today issue a paper for consultation in which we deliver our view on what constitutes a sound and prudent remuneration policy. We will not just focus on executive pay but on the overall remuneration schemes banks have in place.

- A fourth area concerns the overall principles for risk management. We have been mandated by the EU institutions to review the present regulation and propose any changes that may be appropriate. This work will also be reported at the end of March 2009.

- Finally I would like to mention that we, in our analysis of the financial rescue plans, have identified a few areas where CEBS could do more work. One is on the level of capital buffers and another is on the criteria to be used when deciding which instruments can properly be included in tier 1 capital.

I have tried to give you a broad overview on issues at stake within the remit of CEBS. Still I have not mentioned anything about procyclicality, common reporting, cross sector convergence, financial conglomerates, credit rating agencies, CCPS and clearing of derivatives. I can assure you that all those issues are also important.

Thanks for your attention!