***Euro Finance Week***

***The regulatory Framework of European Finance;***

***The Role and Status of Supervision in Europe***

**18 November 2008, Frankfurt**

Kerstin af Jochnick, Chair of the Committee of European Banking Supervisors (CEBS)

Ladies and Gentlemen,

I am pleased and honoured to be invited to this conference. This is an excellent opportunity for me to inform and hopefully to engage in a dialogue on the regulatory framework in Europe. In the middle of the financial crisis the discussion on the organisation of supervision in Europe has been fuelled again. There is now strong demand for having the supervisory colleges up and running and the European Commission has appointed a group of wise men to put forward a report in spring 2009 on the future organisation of supervision in Europe.

Ever since the creation of CEBS five years ago one of the top priorities for our Committee has been to bring about more convergence among banking supervisors in Europe and to facilitate closer cooperation among home and host supervisory authorities. This includes supporting the national supervisors' work on cooperation at the EU level, developing and making efficient the work of supervisory colleges and also that which we call building an EU supervisory culture. And of course, we have throughout made the argument that supervisory authorities must have enough resources for all the challenging work they have to do. This evolutionary approach will gradually deliver convergence among European Supervisors and efficiency in the joint supervision of cross border banks.

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 close to 50 European 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, if we want to reach the full integration of the internal market there is more to do in harmonising the European legislation as well as in developing more convergence in supervisory practices. Supervisory authorities are nationally rooted; although their goals are the same, their ways of working differ and they have different tools available. In short: supervisory culture is different from country to country. Further progress therefore calls for systematic action with regard to regulatory convergence and supervisory harmonisation. CEBS now plays an important role in promoting convergence in supervisory practices in order to minimize regulatory burden and compliance costs for cross border banks.

In my remarks today I will focus on this role of CEBS in strengthening the supervisory cooperation with regard to cross border banking groups and give you an idea of our efforts to set up so-called supervisory colleges and make them work efficiently.

The supervision of cross border groups is not a new area of work for CEBS but an issue which has had high priority throughout our work with the implementation of the Capital Requirements Directive (CRD). In early 2006 we published our Guidelines for cooperation between home and host supervisors. We have put a lot of effort in addressing practical issues emerging from the application of the CRD and the related CEBS' Guidelines. We have also established a permanent operational network consisting of home and host supervisory authorities for a number of the large cross border banks in Europe. This structure is created in order to support enhanced exchange of information and experiences between participating supervisors and to promote a consistent application of supervisory practices across the supervision of these banks. The banks in our sample have also established an industry platform which engages in a regular fruitful dialogue with CEBS' network of supervisory experts.

In December 2007 CEBS published two documents to assist supervisors involved with cross border banking groups: a Template for written agreements, setting out a common framework for the working of supervisory colleges; and a note on range of practices from existing supervisory colleges. This allowed identifying useful references drawing on the experience of authorities that have been refining their cooperation arrangements during a fairly long period of time. The Template for written agreements is currently being tested with the banking groups included in our sample and will be subject to review in the light of practical experience.

The existing CRD already contains strong language requiring supervisors to cooperate closely with each other and foster information exchange (Art. 132), under the coordination of the consolidating supervisor. The currently proposed amendments to the CRD further underline this by providing a legal underpinning for colleges of supervisors. CEBS welcomes this initiative by the Commission. CEBS has been working hard within the so-called Level 3 framework, but I believe that our work could benefit from a stronger legal basis.

A recent good example of where close multilateral cross-border cooperation between supervisory authorities has taken place is 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 legal framework of the CRD, it proved to be an efficient ice-breaker for intensification of cross-border supervisory cooperation.

The collegial approach to the approval of Pillar 1 models was also well received by the firms concerned. The evidence of an effective coordination and cooperation between supervisory authorities has stimulated several industry representatives to ask for an extension of the joint decision making process foreseen in article 129(2) of the CRD to Pillar 2 and Pillar 3 matters also.

The Commission's proposals for changes to the CRD reflect these developments, by asking supervisory colleges to agree on key home-host issues (e.g. reporting requirements and capital add-ons for subsidiaries).

One of the major areas of concern regarding the present institutional setting is the ability to manage possible cross-border crises. Under the aegis of the Economic and Financial Committee ministries of finance, banking supervisory agencies and central banks in 2005 developed a Memorandum of Understanding (MoU) on cooperation in crisis situations, which set out principles and procedures for the identification of the authorities responsible for crisis management, the required flows of information and the practical arrangements for cooperation at the cross-border level. In 2008 a new such MoU has been signed, this time including also securities regulators and insurance and occupational pensions' supervisors. A major EU effort in the form of a crisis exercise to test this structure has been planned for the spring of 2009. However, CEBS has suggested that under the circumstances we are already undergoing a real life test and that the simulation exercise should be replaced by a systematic and coordinated gathering of "lessons learned".

In addition to the work on colleges, CEBS intends to build on the momentum of the recent Review of the Lamfalussy Process, and carry out other projects that would promote convergence in supervisory practices and contribute to the creation of a European Supervisory Culture. Among these, I can mention the following work strands:

(i) We have started our first peer review exercise, which means that we will follow up how our members have implemented CEBS' guidelines. We will further explore tools to foster convergence and strengthen the national application of Level 3 guidelines, recommendations and standards;

(ii) We will look at the identification of possible obstacles for harmonisation stemming from differences in supervisory powers and objectives;

(iii) Together with our sister committees CESR and CEIOPS, we will set up a common training platform for supervisors and facilitate staff exchanges.

(iv) CEBS has, again together with CESR and CEOPS, developed some high level principles for delegation of supervisory tasks, to as to reduce burden on both supervisors and supervised entities. CEBS and the sister committees are now working further on the options for voluntary delegation of supervisory competences.

In the perspective of the ongoing financial and economic crisis it is natural to reflect upon the college approach and ask whether it is sufficiently developed to handle a cross border bank in a crisis situation. Is there a need to strengthen the role of the home supervisory authority – the "lead supervisor" concept – or is there even a need for an EU single supervisory model as is promoted by the EU Parliament and the European Banking Federation?

Supervision of cross border banks has to be stepped up. We may not always be able to keep the same pace as the market but the direction is clear. The direction surely is towards more coordination between home and host supervisory authorities within the EU. There is probably a need for a stronger role for the home supervisor to address concerns at the group level and to take fully into account the interests of the host Member States involved.

Given the changes that are now under way in the CRD I clearly foresee an increasing role for CEBS to play, with the necessity to facilitate and coordinate on an EU level, both in regular times and when a crisis occurs.

To be clear, the adequate functioning of colleges for all cross border banking groups provides quite some challenges. This needs to be combined with further efforts to cooperate between supervisors on a global level and with our supervisory colleagues in insurance and securities, concerning the supervision of financial conglomerates.

It is also important that the national mandates to supervisory authorities takes into account the EU perspective and the effects a decision by a national authority may have on financial stability in other countries.

Whether there is a need or desire to set up a European Supervisory Authority, is very much a political issue.

There are a least three ingredients for a good framework for financial markets. You need proper regulation enforced by a proactive and forward looking supervisor, a confidence inspiring consumer protection in the form of strong deposit insurance schemes, and a lender of last resort function.

Do we have those three ingredients in place in Europe for cross border banks? The answer is No. Would it be helpful then to have a single supervisory authority if regulation of financial markets, deposit insurance schemes and the lender of last resort function are still not solved? I think you all can agree with me that a single supervisory agency would not by itself solve the problem.

So what do we need to do?

First, in the EU we have to make sure that there is framework legislation in place that can handle financial markets both under normal conditions and under stress. CEBS has provided the EU Commission with advice on how to make the EU banking regulation more consistent and harmonised. As you all know, we have asked for changes in the areas of liquidity risk management, the large exposures regime and the definition of capital. Recently, CEBS urged the EU Commission to delete 80% of all the national discretions and options presently contained in the Capital Requirements Directive. All these efforts by CEBS will surely help to achieve a more common EU directive. What also helps is a more harmonised implementation of the primary EU legislation. CEBS is playing a big 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 close to 50 cross border banks in Europe we have to make sure that supervisors, when needed, have a legal basis to take action in a converged way.

A second issue of non convergence and outside the brief of supervisors is deposit insurance. A crisis in a major retail cross border bank will inevitably create enormous issues around consumer protection. Will 27 deposit insurance schemes be able to cooperate on payouts in an efficient and well understood way? Will a centralised supervisor be able to cooperate with 27 different deposit insurance schemes in a crisis situation?

Third, on the lender of last resort function and the cooperation with central banks. Cooperation between central banks, supervisors and ministries of finance has developed over the past few years. The MoU on crisis management signed this May is a step forward; the different crisis exercises are also educational. But there are still obstacles in national legislation. In several countries cross border banking groups are not able to freely transfer collateral across borders if needed for liquidity purposes. Another issue that may be even more problematic is the key for burden sharing between the states involved.

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.

To deliver convergence among European supervisors there is no free lunch but just hard work; build the EU supervisory culture; 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 ahead.

Thank you for your attention!