

## **Supervisory Structures: The Home Versus Host Debate and Making Supervisory Colleges Work**

Thank you for giving me the opportunity to present the CEBS view on the supervisory structure in Europe and the way forward.

In addressing this topic I would first like to present my view on the legal foundations which are necessary for effective EU supervision. I will then turn to the core of CEBS' work: working on supervisory convergence in the regulatory area. Regulation in the EU is predominantly the same whereas supervisory practice can be quite different. How do the 27 supervisors in Europe work together in achieving a more harmonised EU practice? What is the role of the college of supervisors? And are supervisory colleges the holy grail for the institutional question of supervision in Europe?

But first I would like to take you back in history to 1992. Do you remember? In 1992 the European passport for banking activities within Europe was introduced. Accordingly it was no longer necessary to get a separate license to establish a banking branch in a fellow EU Member State, and previous restrictions on marketing a product cross-border were removed or reduced under the freedom to provide financial services within the EU.

### **Legal foundations for effective EU supervision**

And what has happened since 1992? The developments in banking have moved very quickly in the last 16 years. As a consequence of the establishment of the common financial services market in the EU, many domestic banks have become EU players with a considerable cross-border presence. We now have around 47 cross border banking groups in Europe. The capital base of the 25 largest banks is about 800 billion euros, half the size of the whole EU banking market. And quite a number of these banks are active in more than 20 Member States within Europe.

And what happened with supervision? The foundations of supervision within Europe did not develop at the same pace.

Yes, for banking branches a structure is in place. They are subject to effective supervision by the country where the head office is located. Since legally the activities in the branch and in the head-office form one interconnected whole, it is – from a legal perspective - quite easy to have the supervision done solely by the home - except for the liquidity supervision which still is a host responsibility.

But for banks with subsidiaries abroad it is a totally different story. We do not have a European passport for banks that undertake their business cross border through subsidiaries. Basically we here still have national legal structures for supervision within the EU:

All bank subsidiaries within a cross border bank are still required to have a separate license in each country where they operate. The supervision of the parent and all the subsidiaries of this cross border bank are still based on the

different national mandates of the supervisory authorities. These national mandates are still based on the interests of national deposit holders and on the financial stability in the national market.

Also, public intervention tools for an ailing bank are still nationally based and differ from one country to another. This makes a coordinated approach towards an ailing cross border bank difficult and fosters national solutions to the ailing bank in question.

Also deposit guarantee schemes still have a national set-up. Every EU country has its own scheme on guaranteeing deposits - albeit in the near future with a common higher minimum payout level and a common maximum payout period of 3 days. These differences in schemes amongst EU Member States may have an effect on the supervision of an EU cross border bank. Banks that remain a going concern might be confronted by flows of retail deposits towards banks in Member States with higher guarantee levels. And a cross border bank in difficulty, could be confronted with different trigger moments for different legal entities of their banking group, making a coordinated and optimal winding up procedure for the cross border bank as a whole, quite difficult, when deemed necessary.

These points have in the past been identified as being paramount to get the fundamentals for EU cross border supervision right. They are part of the EU Council's roadmap for EU supervision and work on these legal foundations for effective supervision by the Commission and the EU Council is underway, but we are not there yet, as I have just illustrated.

### **The EU regulatory framework for effective banking supervision**

Although the building site to get the correct legal foundations for effective EU supervision right is still under construction, we have already been renovating our supervisory home for quite some time.

More specifically, a lot of effort has been made by CEBS in the regulatory field to go from Basel I to Basel II. In our efforts, we have involved the European banking industry, by means of hearings, workshops and consultations. Further we have steadily received input and guidance from our Consultative Panel in our work, including our priorities.

Primarily CEBS has provided the EU Commission with advice on how to make the EU banking regulation more consistent and harmonised from the outset. As you all know, we have asked for further legislative changes in the areas of liquidity risk management, the large exposure regime and in respect to definition of capital. Earlier this month, 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, *when* taken up in the legislative process, will surely help to achieve a more common EU directive.

What also helps is a more harmonised implementation of the primary EU legislation, with CEBS' guidelines, aimed to put flesh on the bones of the CRD. As you all know, CEBS has developed guidelines in several technical areas, for

example on prudential filters, on supervisory reporting, on concentration risk, and on model validation.

Does CEBS have a sufficiently harmonised approach from a technical perspective? We already did accomplish a lot but still have a way to go.

The main areas for further harmonisation are requirements for banks under Pillar 2, a more common approach to definition of capital, and a harmonised approach to measures for remedying the pro-cyclical nature of Basel II. This work will be undertaken by CEBS in close liaison with the BCBS and other international fora, given their global impact.

And furthermore we will have to be aware that although on a European scale the regulatory framework is consistent, Member States have to transpose the CRD changes in their national legislation and to commit to integrate the CEBS' guidelines within their regulatory framework. This all takes time and need be done neither fully nor consistently, given prevailing national practices and interests.

### **Tools at CEBS that contribute to more harmonised regulatory approach**

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.

First of all, we have a common supervisory disclosure framework which is accessible to everyone 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 in the different Member States, with their different legal structures, the CRD has been implemented and to signal possible differences between Member States.

Secondly, all 27 EU supervisory authorities have signed up to do 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. As of next year, 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.

And last but not least, supervisors within Europe have agreed to participate in a mediation mechanism when there would be disputes between supervisors in the exercise of their duties. 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 of a cross border bank. It could also address a level playing field issue between banks in different EU Member States.

## **Tools that address differences in supervisory practice**

All these tools will help to improve a consistent implementation of the regulatory framework.

But having a common regulatory framework is not sufficient for there to be a sufficiently harmonised supervisory practice within Europe, especially relevant for EU cross border banks. Supervisors still have to some extent different cultural backgrounds; different procedures in place for essentially the same supervisory objectives, different skills, different knowledge levels, different approaches to on-site and off-site supervision, and different intervention tools. Such differences in supervisory practice are noticeable in the supervision of cross border EU banks. Especially here it is relevant to have a sufficiently consistent approach, given the importance of these banks for financial stability and the potential impact of a un-level playing field in Europe.

To cope with these challenges in supervisory practices, CEBS has developed and put into practice the concept of colleges of supervisors, and has continuously worked on improvements in our supervisory culture in Europe. The common supervisory culture is being promoted by organising a lot of common training amongst EU supervisors, having staff exchanges, having more people working in CEBS' structures and facilitating intense information exchange between supervisors, where appropriate.

A "college of supervisors" in our view is a mechanism to co-ordinate the practical supervision of a cross border group. This could be 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 work. A recent survey amongst CEBS members showed that home country supervisors have stepped up their effort in establishing such colleges and initiating regular college meetings. For most of the biggest EU banks, colleges are in place.

These colleges are not being organised in the same way, as banking groups within Europe are quite different – in set up and in organisation. The college of supervisors mirrors these differences. Banks that are active in almost all the EU countries but have two to three main markets, like Deutsche or ING, tend to have a core college with the supervisors from these markets, and a more general college session to inform the other host supervisors. Whereas with a cross border bank that mainly operates amongst its neighbouring countries, like Nordea, the supervisors primarily meet as one college comprising all involved EU supervisors.

It should be stressed that the main aim of the college of supervisors is to exchange information and to co-ordinate supervisory action. So practically speaking, the big added value of the college approach is that every supervisory authority can take decisions on a more-informed basis and that there is now an extra opportunity to co-ordinate supervisory activities. But it is not a safeguard to get the same decisions by all supervisors, since the college of supervisors does not change the division of responsibilities between home and host supervisors,

and every supervisor and Member State retains its own decision making powers in respect of its part of the group to which it has given a license to operate.

A possible concern with this college structure is that a more converged approach within the college could lead to bigger supervisory differences between colleges. In order to mitigate this, CEBS has established an operational network between the home and host supervisors involved in these colleges. This network discusses inter alia, the approaches taken for the validation of the models of a cross border bank, in order to reach a more common approach between the larger cross border banks.

### **Are supervisory colleges the Holy Grail?**

Is this college approach, which has been taken up by the EU Ministers of Finance and EU Heads of State, the most promising way forward in the organisation of EU supervision? Or should we go instead towards the single supervisory model as promoted by the EU Parliament and the European Banking Federation? Or should there be a trend towards a more national approach of supervision, given the latest developments of ring fencing on a national level?

Let me first provide my reaction on my latest remark. And now I give my personal reflection. I do not see a possibility to go back in history. Banks have grown internationally, both in Europe and around the rest of the globe. The current situation shows the utmost importance in having adequately capitalised and well managed banks given the globalisation of our world and that business operates cross-border. And supervision is developing – albeit at a slower pace – in the same direction.

So the direction really counts. And the direction surely is towards more co-ordination between line-side supervisors within the EU, a stronger role for the home supervisor to address concerns on the group level and respect for the interests of the host Member States involved. By the way, a bigger responsibility for the home compared to the host is not new; it was first introduced for the validation of credit risk models and we understand from our members has worked quite well. Now the EU Commission proposes within its CRD text proposal as a next step, a bigger responsibility for the home supervisor in two cases: for Pillar 2 capital requirements and for supervisory reporting. The proposals are still under review and at this stage it is not known whether they will be in the final revised text for the CRD.

Given these developments there is surely an increasing role for CEBS to play, with the necessity to facilitate and co-ordinate 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. We began with looking at 10 banks, have now extended this to 18, and in future will have colleges in place for all cross border banks in Europe. This needs also to dovetail with further efforts to co-operate between supervisors on a global level and with the co-operative arrangements with our supervisory colleagues in insurance, in respect to financial conglomerates' supervision. Also going more into the day-to-day practice of

colleges will present some additional challenges, for example the co-ordination of the annual supervisory activities towards a group, and how to cooperate under the current crisis. The crisis is a real time test for our supervisory co-operation. We as supervisors are now on a fast learning track on what works and what does not work in a crisis, and how we can improve the college model. For example, effective information exchange as a home supervisor in the crisis, where there are colleagues from more than 20 Member States is not that easy. In addition, you see that the incentives between home and host supervisors can be different. From the home supervisor's perspective a specific national market might not be that material for its supervision of the bank as a whole, whereas from the host supervisor's perspective it could be its most important player in their market. These differences need to be managed, and lessons are to be learned to optimise this college model. But this model alone is not the panacea.

Some points can be addressed only when the legal structures, as I mentioned in the beginning of my presentation, are addressed. Harmonisation as a sole responsibility for supervisors is not the Holy Grail. We are working hard on the many topics I have just mentioned, aimed at having a properly functioning banking system with adequately capitalised banks and effective risk management, in the interests of the saver and deposit holder in the EU and of the financial stability of the system.

Thank you very much for your attention.