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Helmut Bauer, Bureau Member of CEBS

Discussant in session: CEBS and Basel II in an expanded EU

Good afternoon ladies and gentlemen,

It is a pleasure to be here today and I should like to thank the organisers of this Convention for the kind invitation. As a representative of the Committee of European Bank Supervisors I am grateful for the opportunity to attend this panel and to speak to you on “CEBS and Basel II in an expanded EU”.

This forum offers to all of us a much welcome platform to meet and discuss recent and future developments in financial services and their regulation and supervision in the European Union. We have come a long way since the first European Finance Convention was held in 1987 on the prospects for a European Single Currency. The Single Currency is now well established – perhaps even a little too well over recent months - and another enormous step has been taken: the EU enlargement with the accession this year of ten new Member States.

I am proud to say that CEBS is among the few European committees that almost from the outset operated in “EU 25 mode”. Established in early 2004 we welcomed the acceding Member States and their national authorities as new members to CEBS during our set-up stage. We welcomed them all the more since there is an enormous amount of work ahead of us and help with this work is much needed.

CEBS, as you surely know, is one of the three so-called “level three” committees. As such it is an integral part and important element of the Lamfalussy architecture that has now been extended to European legislation in the field of banking and insurance supervision.

CEBS brings together all the banking supervisory authorities and central banks of the 25 Member States, plus the European Central Bank, and observers from the other countries in the European Economic Area. Our main tasks include

- promoting convergence of banking supervisory practices and supervisory co-operation in Europe,
- providing advice to the Commission on the technical details of Community legislation in the field of banking supervision and
- foster common and consistent implementation and day-to-day application of EU banking regulation.

CEBS is committed to deliver a more level playing field for the industry - in particular through promoting consistency in supervisory practices. We have a set of tools, namely recommendations, guidelines and standards which are all aimed at promoting consistent implementation and application of EU banking regulation in day-to-day supervision. To this end we will also develop the necessary operational networks and network mechanisms for smooth and efficient supervisory co-operation in a cross-border environment.

CEBS’ achievements after its first year of operation are in my view quite remarkable. To give you a flavour of CEBS’ activities, the role it has and the issues it is looking at let me give you a quick overview of what we have done and dealt with in 2004:

- Regarding the finalisation of the draft Capital Requirements Directive we have been giving ample advice to the Commission and also assisted Council negotiations;

- in particular, we were able to broker agreement between Member States on the deletion of more than 20 national discretions in the Directive, thus, reducing considerably the scope for differences and distortions in the implementation of the directive;

- we have made rapid progress towards designing a common reporting framework for capital requirements and the solvency ratio under the new directive and are confident that this achievement will reduce considerably the reporting burden for cross-border banking groups;

- we have published draft guidelines on the supervisory review process and believe that these guidelines represent an important step towards consistent and uniform application of the pillar 2 principles in day-to-day supervision throughout Europe;

- last but not least we have orchestrated a much intensified debate amongst European supervisors on the international accounting standards and, as a result of this debate, have introduced common so-called “prudential filters” aimed at neutralising the effects of the use of new international accounting standards on regulatory capital and thus eliminating distortions in the calculation of current capital requirements that otherwise would occur.

I will stop here and trust that you find this non-exhaustive list of issues that have been dealt with in our first year of operation impressive.

Let me now turn more spefically to Basel II in and from the perspective of the expanded European Union with ten new Member States. Clearly these ten new Member States are offering a wide range of new opportunities in an enlarged and more dynamic European economy. But there is more to the accession of these countries than promising economic opportunities. In particular, there are also important challenges.

There are for instance challenges as those related to the simple fact that with all new member states represented on our committee we have about 60 members sitting around the table. It wasn't easy to find premises in London large enough to accommodate meetings of a committee of that size. And of course debate and decision making can be difficult under these circumstances. In particular since our charter requires us to strive for consensus.

I am happy to say - though - that so far we have been able to reach agreement on all relevant issues. What has helped a lot is the enthusiasm of new members and their committment to the European case. Appetite for debate is coupled with willingness to agree and to find workable solutions. But this does not mean that there are no controversial issues, where members do have different views and often for very good reasons.

With regard to Basel II I would like to focus on a pivotal issue that in the context of an expanded European Union presents itself in a very particular manner. In a manner that eventually sheds light on the future challenges for the design and organisation of banking supervision in Europe. The issue I am refering to is the so-called home host issue that has seen for some time now a rather hot and helpful debate at the Basel level. However, in the European context the issues surrounding the home host question are even more complex. Eventually it is the traditional concept of division of labour and responsibilities in the relation between home and host supervisor that is at stake.

Let me briefly recall how this division of labour and responsibilities is conceived according to the current legislation. As you are all well aware, one of the core elements of the single European financial market is the so-called European passport. Banks that are duly licenced and supervised in their country of origin are thus issued with a European passport that allows them to provide services and set up branches throughout Europe without being subject to any additional licencing requirements or supervision by host country authorities. In contrast, if they set up a separate legal entity in another Member State that subsidiary is fully subject to licencing and supervision by the host country supervisor.

This concept has been working well so far. However, with developments in cross-border banking throughout Europe including in particular central Europe and with Basel II and the Capital requirements directive approaching that concept is coming under increasing pressure.

These are the facts: Branches and subsidiaries of cross-border banking groups operating in the new Member States hold important shares of the host country's domestic market, some of them dominating that market. On average the market share of foreign banking groups in new Member States is around 70% of bank assets. It can't be denied that there are subsidiaries and even branches that have systemic importance for the host country's financial market and it shouldn't come as a surprise that under these circumstances information exchange and close co-operation between the host and the home supervisor is viewed by the host supervisor as paramount. Supervisory authorities in new Member States are therefore keen to have a greater share in the day-to-day supervision of the cross-border banking group. Very understandably they have a strong interest in a better understanding of the group as such including its risk management and internal control systems of which in many respects the host country operations form a fully integrated part.

But the quest for a new quality of home host co-operation is not only triggered by our new members. The quest for better and closer co-operation among home and host supervisors of a cross-border banking group is also driven by Basel II and the new Capital Requirements Directive – and by the industry.

Cross-border banking groups have a strong interest in what one could call a "One face to the customer" approach to cross-border supervision. They would much prefer to deal with a single supervisory authority as their point of contact for the group as a whole and would wish that point of contact to coordinate all the regulatory and supervisory services needed for the group to operate across Europe. This request coincides and is well in line with a core feature of Basel II and the Capital Requirements Directive. The supervisory concept underlying these fundamental regulatory reform projects relies upon and at the same time is aimed at fostering best practices for holistic risk management approaches which in many respects are to be applied to the group as a whole without much distinction between branches and subsidiaries.

Thus, feeded by different and partly conflicting sources there is considerable momentum to develop a new quality in the co-operation of home and host supervisors. Host supervisors responsible for domestic markets with strong and possibly dominating branches or subsidiaries of foreign banks emphasize the need to protect local depositors and to ensure the financial stability in their jurisdiction. Cross-border banking groups are looking for streamlined supervisory processes responding to the needs of integrated international business operations based upon branches and subsidiaries across Europe. Both industry and supervisors acknowledge the need for holistic and integrated risk management systems responding adequately to the group-wide risk profile.

This home-host debate goes right to the heart of how supervisors interact within the single market. We have seen a lot of discussions recently on, in some respects, competing, concepts. There is talk of a lead supervisor, often seen as a necessary step towards a single European supervisor. The Capital Requirements Directive stops short of this concept and proposes in Art. 129 a sort of sophistication of the traditional concept of consolidated supervisor. This approach respects by and large the legal responsibilities of the host country authorities. They remain responsible for the supervision of domestic subsidiaries of cross-border banking groups. Yet the approval of new pillar 1 risk measurement techniques for the whole group is eventually confered to the home country supervisor also with regard to European subsidiaries.

Evidently, in the medium- and long term perspective there is a lot at stake. However, I believe that, more than anything else, the complex challenges we are facing require some serious efforts to improve substantially the quality and intensity of co-operation between home and host supervisors. This is less an issue of institutional set-up and reallocation of supervisory responsibilities between home and host supervisors. Rather it is an issue of supervisory practices and co-operation in day-to-day supervision.

CEBS does understand the industry's concerns. Groups with cross-border establishments want to reduce costs and administrative regulatory burdens, they want to be able to grow, to meet global competition and to deliver to their shareholders and customers. More efficient banking benefits the economy as a whole, by allocating capital more efficiently and translating savings into investments.

Supervisors have a role to play in this and are committed to do so. However, a "One face to the customer" approach does not require in the first place legislative change and reallocation of responsibilities and powers. More than anything else it requires better co-operation and co-ordination between supervisors, consistency in supervisory practices and uniform application of harmonised European banking legislation. And finally it requires cross-border operational networks that enable supervisors to respond to the demands of cross-border banking groups. That is what CEBS is set to deliver. CEBS is neither a home nor a host supervisor. But its members are. Therefore, we see relevant issues from all sides and are working hard to come to solutions that work for everyone. Solutions that are based on co-operation, common standards and guidelines and mutual trust.

Thank you for your attention.