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Economic and Monetary Affairs Committee of the
European Parliament
Brussels, 2 October 2007

Madame la Présidente, Mesdames et Messieurs les membres de la Commission Economique et Monétaire,

It is a pleasure and an honour to present CEBS' work to the Economic and Monetary Affairs Committee of the European Parliament. One year has passed since our last meeting. Such regular events are very important to us, as they provide an opportunity to receive your feedback on the progress made and on the specific initiatives we have under way. Keeping a close relationship with the European Parliament is of paramount importance to CEBS, especially in the context of the current review the Lamfalussy architecture.

Two elements give a peculiar flavour to today's discussion:

First, 2007 is the year in which you and the other EU institutions are reviewing the working arrangements of the so-called Lamfalussy architecture. You will discuss whether the present arrangements are up to the challenges of a more complex and integrated financial market in the EU and propose possible improvements. This review goes well beyond CEBS: it touches upon all levels of the framework, including rule-making at Level 1 and 2 and enforcement at Level 4, as well as span beyond banking, to our sister Committees CESR and CEIOPS. But of course the outcome of this review will have a major impact on our work.

Second, the current market developments constitutes a "reality check", reminding us of the importance of the institutional arrangements for financial stability. We are not dealing with theoretical issues of institutional engineering; we have to make sure that we are in a position to effectively protect the interest of European citizens. Can young organisations like ours give a positive contribution in practice? And what lessons can we learn from the recent events?

When I spoke to you last year, I mentioned a number of initiatives that have progressed over the last twelve months. They can all be subsumed under our three tasks, **the three "Cs": Contribution to EU legislative process, Convergence, Cooperation.**

Let me start with our efforts to promote convergence in day to day supervisory practices.

Last year we launched an online survey to gather feedback from all interested parties on the progress made by CEBS in the first three years of activity. Let me take this opportunity to thank the Members of this Committee who actively participated in our exercise. The results of the survey, which were presented at our May Conference, highlight that most of CEBS' stakeholders are very or fairly satisfied with what they see coming out of CEBS and how the committee works. But it also highlights areas in which we could and should do better.

Areas for improvements include: striking the right balance between principles and detailed rules, as well as further improving public consultation processes.

But maybe the key message in the survey is on the impact on national day-to-day practices. The respondents consider that the approach followed by CEBS is the appropriate one to achieve convergence; they praise the quality of our papers; they consider our work an important contribution to the goal of integrated financial markets in the EU. But still they highlight a gap between the design of policies by CEBS and the delivery of convergence in day-to-day practices by national authorities.

There is of course a timing issue here: the Capital Requirements Directive (CRD), on which CEBS focused most of its work, has entered into force only after the survey was conducted (and will be applied for advanced approaches only from January 2008). Moreover, several of the initiatives launched by CEBS to foster convergence of approaches, like the very significant efforts on common training and staff exchanges, are likely to deliver results only after a critical mass of supervisory staff across Europe has been directly involved.

That is why, we did not find these results surprising. As a matter of fact, CEBS' catchphrase for the work programme in 2007 (finalised before the conclusion of the survey) was "from design to delivery", from the design of policies for convergence to the delivery of actual convergence in day-to-day supervision. We are very much aware that this is the real test for CEBS' success.

As I reported to you last year, our first effort has been in the issuance of guidelines focused on the CRD: our work is now being collected in a consolidated guidebook, which will count more than 500 pages. CEBS guidelines are mostly principles-based, which by nature leaves ample room for national adjustments. They create an important common ground, but we are aware that, by themselves, they could fail to generate a sufficient degree of convergence in practices. To promote convergence in day-to-day supervision with principles-based guidance is, by nature, quite a challenge. We are therefore developing a number of practical tools, which are expected to bridge the gap with day-to-day practices.

We have established convergence networks of technical experts in any relevant areas in which CEBS has worked, to follow the implementation

issues that emerge in the day-to-day application of our guidelines. These networks include line supervisors and should therefore help in ensuring greater commonality in application. We are also opening web-facilities for implementation questions, replicating tools already adopted at the national level to make sure that a response given to an interested party is immediately visible and applicable to others. In some cases, we are also developing joint assessments by teams of experts from different authorities: for instance, the assessment for the regulatory recognition of External Credit Assessment Institutions (ECAIs) applying to several EU jurisdictions under the CRD has been conducted jointly under CEBS roof by a team of experts, and then the decision has been incorporated in national administrative decisions.

On top of these practical tools, we are finalising the implementation of the new convergence tools recommended by the report of the Financial Services Committee, the so called Francq report.

In particular, CEBS has just put in place a **mediation mechanism** between banking supervisors, to address possible supervisory disputes. The aim is to facilitate and speed up the supervisory procedures set out in the Capital Requirements Directive and to support the application of the pre-existing cooperation tools among supervisors.

CEBS is also about to set up a **peer review mechanism**, which relies on an independent Review Panel, a rigorous and objective assessment methodology and a transparent process. This should allow to make sure that the standards agreed at the CEBS table are effectively put into practice. The mechanism also includes a 'comply or explain' principle, which envisages that a national authority not implementing CEBS guidelines properly will have to explain why this is the case. We are aware that the possibility to make Level 3 tools, such as CEBS guidelines, legally binding is being debated. We are not recommending this, because we are concerned that this would immediately generate an additional layer of rules and convey the impression that the Lamfalussy process is increasing the regulatory burden, instead of streamlining the supervisory processes. Effective peer review, coupled with a "comply or explain" principle, should deliver far reaching results.

The **supervisory disclosure** framework set up by CEBS nicely complements mediation and peer review, enhancing the peer and market pressure towards consistency of supervisory approaches.

In the medium term, such tools will be supported by the emergence of a **common European supervisory culture**. This is at the core of our efforts. We already launched a significant number of common training initiatives for supervisors: more than 170 members of staff from national authorities have attended CEBS sponsored training programmes in 2007 only. A framework for short term secondments has been designed to promote exchange of staff in the context of the supervision of cross border groups. In this area CEBS is working in close connection with its sister committees, CESR and CEIOPS: we launched a joint initiative to

promote training programmes on issues of common interest for the three sectors.

Will all these efforts be enough? Are we going to meet the ambitious expectations set by our stakeholders? This is a difficult question partly because the notion of convergence has changed quite significantly since CEBS started operating and, as a result, we are aiming at a moving target: few years ago, the objective was to ensure a consistent implementation of Basel II while maintaining enough flexibility for institutions to adapt; now, we are often asked to deliver country-neutral approaches in all areas of our work. I believe we need to elaborate further on the **notion of convergence**, so as to have an ex-ante common understanding on what CEBS is expected to deliver; this would also favour proper ex post assessment and accountability.

My view is that in some areas we should indeed aim at having same problem receiving same supervisory answer. In other areas, this might not be warranted, and could even be counterproductive. We should remind ourselves that in the Single Market operate a huge number of small and local banks who raise different supervisory concerns from large and sophisticated global firms. Proportionality is the key concept on which we have to rely.

We have also to stress that the degree of supervisory convergence CEBS could achieve is limited by significant regulatory constraints. A regulatory setting is now crystallised in Community legislation that leaves ample space to national adjustments. As we are now in a regulatory pause, there isn't a lot of room for immediate adjustments. The most apparent examples are the high number of national options and discretions we have in the CRD. We recently received a Call for Advice from the European Commission to significantly reduce them, but it will not be an easy task to provide technical input in an area that is so politically sensitive.

We are aware that our focus will have to increasingly shift also to regulatory advice, which brings me to the second part of my intervention: **CEBS' contribution to the EU Better Regulation Agenda.**

CEBS is keen to contribute to an evidence-based policy making: surveys have been carried out, hearings and technical expert meetings have been held with industry experts in the context of the calls for advice on own funds, large exposures, commodities business and liquidity. I will come back to the liquidity and large exposures later on.

CEBS is also jointly with his sister Committees CESR and CEIOPS finalising a methodology for impact assessment. It is a practical tool, which will be adopted consistently across sectors and is expected to assist the Committee in its policy analysis and in the course of formulating recommendations.

The work on the **definition of own funds** is key for supervisors. CEBS fact finding exercise helped the Commission to identify, as a priority, the convergence on hybrid instruments, which combine equity and debt characteristics. Ensuring that the instruments issued by banks are of adequate quality to qualify as regulatory capital is of paramount importance. Moreover, supervisors have to keep pace with a fast changing and very innovative market. Our work identified important similarities in the basic concepts used by supervisors, but also important differences in treatment, which need to be addressed in order to deliver a level playing field in Europe. In this area we are also closely cooperating with our colleagues in the insurance field, to identify the similarities and differences in the definition of own funds in the banking and insurance sectors, assessing the impact of the differences on the supervision of financial conglomerates and advising the Commission as to possible approaches to address these differences in the forthcoming review of the Financial Conglomerates Directive.

The work on financial conglomerates has taken off and is proceeding well, with focus on cooperation arrangements, equivalence of third countries supervision, concentration risk and intra-group exposures. CEBS has also started a joint exercise with CEIOPS to compare and discuss the principles and technical instruments for prudential supervision in the CRD and the Commission's proposals for Solvency II.

I would now like to move to the third 'C' I mentioned above:
Cooperation among supervisors.

Our work on supervisory cooperation moves in two parallel and mutually reinforcing directions: (i) multilateral cooperation, in which the Committee is directly involved as a hub for information exchange; and (ii) cooperation within colleges of supervisors, i.e. between the home and host authorities in charge of a specific cross-border banking firm.

In the first area, we had an important test with the recent turmoil. CEBS had been quite active: bilateral contacts have been coupled with an informal ad hoc meeting of the Committee. We had an extensive exchange of confidential information of quantitative and qualitative nature, and an in depth discussion on recent market developments. We are considering making these exchanges of confidential information a regular feature of our work, through teleconferences. The US General Accounting Office paid us a visit recently, notably to discuss the impact of the interconnectivity and globalisation of financial markets in wide spreading risks. Supervisory cooperation is a reality.

In the second area, CEBS provides a framework for cooperation and an interconnection between the different supervisory colleges, so as to learn from each other, as well as identify and address possible consistency issues. Our key project to improve the cooperation and coordination of the supervision of cross-border groups, the so-called 'operational networking' tested on 10 groups will be evaluated (and probably extended) at the end of this year. Good practices applied by the colleges of supervisors of these 10 groups are identified; skeletons for divisions of tasks are shaped, for

instance by designing common terms of reference for teams of supervisors from different countries performing joint assessments on the economic capital models of sophisticated banking groups.

CEBS going forward

Going forward, CEBS intends to further elaborate on its experience and submit to EU institutions some concrete proposals to improve the practical working of the arrangements.

At the same time, the effectiveness of the arrangements is depending also on their ability to respond to financial market developments. That is why we now focus on the regulatory and supervisory lessons to be learnt from the recent financial market distress.

What started as a repricing of US subprime mortgage credit risk has developed into a more widespread repricing of credit risks, resulting in a more general risk aversion and significant liquidity stress. Banks started facing a situation in which the interbank market was not always functioning normally and liquidity lines granted to various Asset-Backed Commercial Paper (ABCP) programmes were suddenly drawn. This generated a complex interaction of liquidity risk with credit, market and reputation risks.

The good solvency and profitability position of most European banks is very reassuring. But the unfolding of events requires careful analysis, to identify pressure points and possible need for regulatory and supervisory actions.

It is obviously rather difficult and premature to express a complete and fair judgement at this point in time, as the turmoil is not over yet. But we are certainly comforted in our efforts to continue and gear up our work on **liquidity risk**. This is maybe the most traditional banking risk, but with sophisticated financial instruments it can take rather different and unforeseen channels to materialise

CEBS has already started reviewing supervisory approaches to liquidity risk in line with a call for technical advice received from the Commission. The results of this exercise have been published in August 2007.

The key findings show that supervisory approaches to liquidity risk remain rather broad brush and obsolete as they do not reflect the changes in market practices. This said, EU supervisors will have to carefully consider how far they can rely on internal models developed by banks. Recent events will provide some evidence regarding the robustness of the banks' modelling methodology and stress testing techniques.

Difficulties at some European banks also stressed how important it is for supervisors to look at the institutions' management of concentration risk, including measurement of off-balance sheet exposures. CEBS is reviewing the current **large exposures regime** and is expected to submit its technical advice for public consultation early next year.

At our plenary meeting last week we held a preliminary discussion on the lessons to be learned. A number of additional issues were highlighted. For instance, there is agreement in the supervisory community that we need to look more carefully at valuation methods and transparency for structured products. But, in doing that, we need to find the right balance between falling into the temptation of "supervisory over-kill" or being complacent.

CEBS will continue its active collaboration with CESR with regard to the **rating agencies**. In particular, CEBS and CESR have a cooperation channel already in place to make sure that Commissioner McCreevy's request to CESR to review the rating process of structured finance instruments fully incorporates the role of the rating agencies in the Capital Requirements Directive and the use of external credit assessments for capital requirement calculations in the Standardised Approach and the Securitisation Ratings Based Approaches.

Some criticisms are being voiced on the regulatory treatment of credit exposures transferred to non regulated conduits. Let me just point out that most banks are still operating under Basel I, as 2007 is a transition year. Basel II is actually a step forward in covering off-balance sheet exposures under regulatory capital requirements. At the same time, we need to check some areas of Basel II in light of recent events: Pillar 3 disclosure, the securitisation framework, the mapping of the external ratings to risk weights and the incremental default risk charge in the trading book are areas on which we will focus our attention in the coming months.

Finally, although the recent turmoil has not triggered a crisis with cross-border dimension, it has recalled to us how important it is to be prepared in case something goes wrong. This is the natural bias of supervisors, who have to focus on tail events, however unlikely they are to occur.

CEBS, in cooperation with the banking Supervision Committee of the ESCB, has already developed recommendations for **cooperation in crisis situations**. Now we are further digging into the practical arrangements to allow operational networks, in an appropriate format, to facilitate exchange of information, assessment of the potential financial crisis as well as coordinate external communication.

Conclusions

Last year, we were talking about CEBS as a Lamfalussy child, three years old, standing at a cross-road, holding its breath before moving to the next phase of its life. One year later, after all the efforts in making 'convergence' real, in bringing forward all the benefits to cooperate, and in improving the regulatory setting for all types of EU institutions, CEBS is close to be out of breath.

We are aware that the Lamfalussy review is likely to increase the demand on CEBS and its sister committees even more, and we are getting ready for these challenges. I would like to suggest that if the tasks and responsibilities of CEBS are upgraded, you also consider endowing the Committee with the appropriate status and tools to achieve its objectives. CEBS is not asking for any radical change of the present arrangements, but for concrete incremental improvements to help us meeting the expectations of EU institutions and other stakeholders. We do not ask to be transformed into an EU regulatory agency, but we find odd that a Committee entrusted with such a daunting task cannot be mentioned and attributed tasks in Community legislation. This would definitely reinforce and clarify our role, for instance in bringing forward the work on operational networking. We are not asking to endow us with legally binding tools; but a strong political commitment by Member States to renounce to national preferences when necessary for the sake of convergence would help. Again, the example of national discretion is a point in case.

The European Parliament is a key institutional player, and a convinced political support to our work is extremely important. This could possibly be done also by modifying our mandate and sharpening its focus on Level 3 tasks. Of course, greater political backing should go hands in hands with greater political accountability. I am sure that you will consider that our meeting today is a step in this direction.

Thanks a lot for your attention!