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The EBF is committed to supporting EU policies to promote the single market in financial services in general and in banking activities in particular. It advocates free and fair competition in the EU and world markets and supports the banks' efforts to increase their efficiency and competitiveness.

CEBS Guidelines on the joint assessment and the joint decision

EBF Response to CEBS CP 39

KEY POINTS

The EBF has long been participating in the opinion building process for these questions and is keen to keep on contributing to the debate with CEBS. Across these guidelines, we identify several of EBF's calls and arguments, especially as regards:

- the recognition of the ICAAP as an institution-driven process,
- the indications to consider diversification benefits in the overall assessment of the college of supervisors, and
- the need for supervisor's understanding of the differences between the internal capital estimates and regulatory capital requirements.

We welcome the guiding principles and the objectives pursued by CEBS in striving to provide tools for reaching a shared understanding of the capital adequacy of banking groups.

However, there is **a fundamental difference** in the way the industry understands the direction of the supervisory process in cross-border groups (top-down versus bottom-up).

There is also **a risk** of multiplying the stress tests under different criteria, an issue that the guidelines should help to avoid.

We would also like to note three outstanding **concerns**, namely the transparency of supervisors in their evaluations, the formal framework for the feed-back process and the frequency and remittance dates of the ICAAP.

Finally, we would highlight the **challenge** of consistency that the practical implementation of this useful set of templates would entail.

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INTRODUCTION

The EBF welcomes the work carried out by CEBS in preparing the guidelines for the joint assessment of the SREP and joint decision regarding the capital adequacy of cross-border groups. The EBF has long pursued the issuance of clear guidelines in all matters within the supervisory scope. We understand CEBS's desire to promote good industry practice among firms and found CEBS's draft principles and guidance useful and thought-provoking.

The EBF was invited to express the views of the banking industry at the CEBS seminar about ICAAP that took place on 22 October 2009 in Rome. On that occasion, we indicated that the industry would welcome some formal guidelines for the assistance of banks. In this vein, we appreciate the guidance put forward by CEBS.

DETAILED COMMENTS

1.- Appropriateness of the templates

We welcome the proposal of CEBS to define examples of common templates and scoring scales and criteria that should be used by supervisors in the assessment process. This initiative can only improve the communication process – between supervisors and from supervisors to banks – in terms of organisation and clarity.

Nevertheless, we would like to point out that consistency in the practical application of these templates is essential for the functioning of the system. In this regard, the CEBS and, moreover, the future European Banking Authority with its enhanced attributions, should foresee a way to ensure consistency among supervisors.

The placement of an observer in the college of supervisors could be a starting point to gather meaningful information on the practical implementation of this framework across colleges. There will be a need for comparing the criteria applied across colleges to ensure the preservation of homogeneity.

2.- Direction of the supervisory process

A major concern of cross border groups is the bottom-up approach followed in the SREP. As a matter of principle, the supervision of an international group should be performed following a top-down approach. This entails a previous planning leaded by the consolidated supervisor including clear statements on the documentation (ICAAP) and stress tests to be performed uniformly at the global level and the solo level.

In our view a top-down joint assessment of the Group would be essential in terms of capital calculation, stress testing, risk management and control, as well as in determining which local issues are relevant at the Group level (i.e. local concentrations, principle of proportionality within the Group structure, internal capital flexibility, etc).

We believe that it is necessary to create a more structured cross-border process for the SREP and we agree with certain aspects of CP39. In particular we hope that the combination of issues and determination of key issues relevant for the entire group would be a step forward from the current process in which local regulators virtually ring-fence the banks within their own jurisdiction.

Moreover, the top-down perspective would allow management to handle internal capital allocation and to manage the banking group across borders in a more efficient manner. In contrast, the bottom-up approach leads to redundancy of effort, documentation and reporting which would be better spent developing risk models, stress testing and analyzing the group-wide risk profile.

The starting point in the fifth paragraph in the first chapter would give rise to complications since it emphasises the national methodologies and the national Risk Assessment Systems (RAS). In our view an ICAAP-process is useful on an aggregate level. The suggested bottom-up approach would require much more work, for both banks and supervisors, without adding much value, in our opinion. To consolidate the different parts of the organisation instead of focusing on the aggregate level increases the risk to lose focus on the actual main risks. Also it makes it more difficult to deal with the different aspects of concentration and diversification. As for the decision on the capital requirement, we see a risk that it will be the sum of the capital for each and every subsidiary, instead of being the actual demand of capital for the group. We would welcome further consideration from CEBS on this issue.

Of course, national specificities need to be regarded and host supervisors should be expected to contribute with their local knowledge to the joint assessment of the banking group. But the process should start at the group level and be driven from the college of supervisors. CEBS would be best placed to ensure proper coordination in the college and the respect for national features notably of countries where the majority of the banking industry is owned by foreign financial institutions.

As regards the obligation to report, we would expect that the principle of proportionality be respected for the inclusion of subsidiaries on a stand-alone basis. Therefore, only material branches or subsidiaries should be subject to individual requirements and these should share the formats and criteria agreed globally in the college of supervisors. The CP39 document is written in a way that it can be interpreted as if the ICAAP and the SREP were to be performed in each and every legal entity of a group. This would mean a huge amount of work without adding much value. In our opinion, the consolidated supervisor should organise the structure of the SREP according to the particular internal structure of the group (country-wise, business-driven, etc.).

3.- Multiplication of stress tests

We are concerned about the level of stress testing that the supervisors may imply and the consequences that result from any over-emphasis. There are two manifestations of this issue, supervisor versus bank, and group versus solo entity.

We have identified that firms could be subject to three levels of mandatory stress tests: compulsory tests determined by the institution’s consolidating supervisor, tests required by the college of supervisors, and tests set by various national or regional authorities. A balance needs to be struck between testing undertaken by the firm to support the use test and the testing mandated by supervisors. Over emphasis on supervisor-mandated testing risks crowding firms’ own risk management and could lead to double counting.

Stress testing is resource intensive and we are concerned that considerable stress testing will be required at the legal entity level. Undertaking stress testing at this level is burdensome and risks conflicting with firms own risk management processes where portfolios are looked at on a group wide basis. Moreover, a combination of stress testing at the solo level and a direct link between stress test results and capital requirements could lead to significant capital resources being locked up in individual subsidiaries severely restricting a firm's ability to manage its capital effectively. We understand that the objective of regulators is to promote stress testing rather than to mandate the location or level of capitalisation within individual legal entities. We support such an approach, as we believe that firms should be encouraged to maintain a holistic view of their risks and operations at the group level, and continue to manage their capital resources in an efficient manner reflective of the risks being assumed. Furthermore, for some institutions, decision making authorities are not aligned to solo entities, limiting the value of stress testing at that level.

4. ICAAP: Solo versus group level

The ICAAP at solo, i.e. legal entity, level has little importance from the perspective of the parent company, whose primary focus is on business units. It is therefore highly important that supervisors refrain from imposing onerous additional requirements which do not reflect economic capital management at group level.

- It should not be mandatory to have capital allocation models which allocate capital to individual risks at solo level.
- Non-significant subsidiaries should not be required to prepare an ICAAP but only be treated as part of the group. Significant subsidiaries should not be required to prepare different patterns of ICAAP. The college of supervisors should consider technical reasons that may prevent certain entities from applying the central model.
- It should be possible to take account at solo level of diversification and hedging effects achieved at the level of the group (solo ICAAP with group-wide diversification). A subsidiary may carry risks which, though too high from a solo perspective, are justifiable at group level. It should be permitted to take account of this aspect in the solo ICAAP by offsetting part of the risk against diversification and hedging effects which have been calculated at group level and allocated to the group's individual legal entities.
- If the host supervisor recognises a company's group ICAAP, it should be possible to dispense with ICAAPs at solo level.

5.- Transparency of evaluations

We are of the view that supervisors should share with the banking groups the results of the evaluations performed. This is essential for the banks to understand what can be done in order to improve the points where supervisors have identified weaknesses.

We understand that in general supervisors would be willing to be transparent towards the banking groups. However, we have not seen any mention to this point in the guidelines and would appreciate to see how it is considered in the final paper. This way, all supervisors throughout Europe should act in the same conditions of transparency.

6.- Frequency and remittance dates of the ICAAP

We would welcome clearer guidance on the remittance dates and frequency for the ICAAP's submission. We understand the supervisors' need to distribute the supervisory workload all through the year and for that reason, global coordination would be necessary to align the cycles and timetables of different supervisors and colleges of supervisors.

The frequency of the joint assessment should be yearly and aligned with the preparation of the ICAAP and the remittance dates should be discussed and communicated in advance.

7.- Feedback process

Along the lines of transparency and remittance dates, there should be a formal framework for the delivery of information from the bank to the supervisor and for the feedback to the bank.

Certainly, banks should know in advance when the supervisors will give them feedback about the documentation and evaluations of the capital adequacy.

8.- Consistency

As commented in the summary, the EBF welcomes the templates put forward by CEBS. Nevertheless, we should be aware of the problem of consistency that they can give rise to. There is need, therefore, for ensuring that the same level of practice receives the same score in different colleges.

Not only convergence within the college should be pursued but also convergence across colleges of supervisors is key in ensuring a level playing field.

The challenge should be faced by way of a centralised body of knowledge and expertise, which would ideally be under the remit of CEBS. Looking forward, the future European Banking Authority would be best placed to play a key role in ensuring consistency in the evaluations.

9.- Involvement of the banking group

We would like to remark the importance of a close interaction between the supervisors and the banking group. This interaction should take place at least in:

- the preparation and submission of ICAAP reports,
- the dialogue between individual entities and the respective supervisors,
- the coordinated dialogue between the college members and group functions,
- the communication of the results of the joint assessment and decision to the group,
- and the dialogue between the group, its entities, and relevant supervisors to discuss the results of the assessment.

Finally, we would consider it important to carry out an implementation study one year after the implementation of these guidelines.

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