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European Savings Banks Group (ESBG)

Response to CEBS's Consultation Paper on the application of the Supervisory Review Process under Pillar II

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Profile European Savings Banks Group

The European Savings Banks Group (ESBG) represents 24 members from 24 European countries representing 968 individual savings banks with around 65 000 branches and nearly 757,000 employees. At the start of 2003, total assets reached almost EUR 4355 billion, non-bank deposits were standing at over EUR 2080 billion and non-bank loans at just under EUR 2195 billion. Its members are retail banks that generally have a significant share in their national domestic banking markets and enjoy a common customer oriented savings banks tradition, acting in a socially responsible manner. Their market focus includes amongst others individuals, households, SMEs and local authorities.

Founded in 1963, the ESBG has established a reputation as the advocate of savings banks interests and an active promoter of business cooperation in Europe. Since 1994, the ESBG operates together with the World Savings Banks Institute (WSBI, with 109 member banks from 92 countries) under a common structure in Brussels.

The European Savings Banks Group (ESBG) welcomes the opportunity granted by the Committee of European Banking Supervisors (CEBS) to comment on its approach towards the implementation of the Second Pillar of the new Capital Adequacy Framework.

The ESBG welcomes in general the proposed principles, which clarify CESB's views on the duties and responsibilities of supervisors and banks in the Supervisory Review Process.

General Comments

ESBG Members believe that CEBS' Consultation Paper constitutes an excellent basis for implementing the Second Pillar of the new Framework, but would nevertheless like to make the following general comments:

Proportionality

ESBG Members welcome CEBS' mention of **proportionality** as a key concept to both the ICAAP and the SREP, since the requirements under the two processes should be in line with the actual risks entailed. In this context, the ESBG believes that CEBS should bring some clarity regarding the criteria which should be used to apply the proportionality principle. We believe that the criteria mentioned under Principle XI of the SREP (**size, risk profile and complexity**) should be used throughout the paper as a guideline to ensure appropriate proportionality, instead of the often used concept of "large and complex institutions".

Level of detail – supervisory disclosure

A number of sections of the Consultation Paper are deemed to contain too many details as well as too many definitions. ESBG Members do not believe that an overly prescriptive approach is appropriate, as it might impede the necessary flexibility that both supervisors and credit institutions need. The level of certainty required by banks might be better achieved by increasing supervisory disclosure rather than by designing overly detailed rules and guidelines. **Increased supervisory disclosure** would help the banks understand better the approach of their supervisor, without burdening them with excessively detailed requirements.

In line with the previous comment, the ESBG believes that the CEBS paper should be more prescriptive regarding certain specific obligations of the supervisors. In particular, section 779 of the new Basel framework indicates that "*Supervisors should make publicly available the criteria to be used in the review of banks' capital assessments. If a supervisor chooses to set target or trigger ratios or to set categories of capital in excess of the regulatory minimum, factors that may be considered in doing so should be publicly available*". We do not believe that these indications are properly reflected in CEBS' Consultation Paper, which should accordingly be amended.

Consistent implementation

The ESBG believes that it is of the utmost importance to strike the right balance between a consistent implementation of the new Basel Framework throughout the European Union, and to grant Member States sufficient room for manoeuvre to implement the new framework at their national level. In this context, we believe that in some areas of the new Framework, Member States should be permitted to use flexible solutions to address specificities in their national fiscal or legal regime. This flexibility will be necessary in the identified areas as long as these differences continue to exist. As such, when deciding whether a national discretion clause is necessary or not, the objective of creating a level playing field at the EU or international level needs to be weighted against the functioning of the national market.

Annex B on definitions

Finally, Annex B of the Paper contains proposals for definitions of a series of **risk factors**. ESBG Members regret that CEBS intends to cover all possible risk factors faced by banks, whereas the new Basel Framework only refers to **material risks**. Against this background, the list of definitions should be removed, and instead reference should be made throughout the paper to the "material risks" of the Basel Framework.

Specific remarks on "section 2 – Supervisory Review Process"

Principle 1 (indent 7) indicates that "*banks should have a process for assessing their overall capital adequacy in relation to their risk profile and a strategy for maintaining their capital levels*". The ESBG supports this principle, but believes that a similar recommendation should be added, concerning minimum requirements on the processes that supervisors should have in place.

Indent 8 states that the supervisory authority "*should have strong risk assessment capabilities as part of its review and evaluation (...)*". Having regard to the fact that the size, number and complexity of credit institutions that are active in a given market can vary a lot, we would favour the wording "*should have appropriate risk assessment capabilities (...)*".

Indent 9 mentions that the SRP prescribed in the EU Directive "*seeks to ensure that institutions hold internal capital which is consistent with their risk profile and strategy*". The ESBG believes that the objective of consistency should be further specified.

Referring to the section of indent 10 that relates to the SREP, one could conclude that the SREP obliges supervisory authorities to identify prudential measures and to take actions. We are of the opinion that CEBS should make it clear that this is just one option, as supervisors may as well decide not to take action at all.

Indent 12 indicates that "*it is intended that there will be a close interaction between (...) the SREP and the ICAAP, especially so for the larger, more complex and systematically important institutions. This interaction will generate an important and necessary dialogue, and feedback mechanism, (...)*". The ESBG welcomes this increased interaction between SREP and ICAAP, as it is necessary to maintain a dialogue between supervisor and credit institution. In line with the comments made above, the ESBG is of the opinion that the criteria of the "risk profile" of the institution should also be taken into consideration.

Finally, indent 16 requires the institutions to assess the "*impact of economic cycles and other future business variables on their capital needs*". More specifically, the text indicates that "*for larger (...) institutions this may mean developing a stress and scenario framework (...)*". In this context, we are of the opinion that CEBS should make it clear that Pillar II does not require additional stress testing above those defined in Pillar I.

Specific remarks on "section 4 – Internal Capital Adequacy Assessment Process"

Section IV (d) deals with the possibility to outsource parts of the ICAAP. We support the view that the high level principles on outsourcing developed by CEBS should serve as a basis to identify the situations in which parts of the ICAAP could be outsourced, and under which conditions[1].

High Level Principles VII and VIII of the ICAAP indicate that qualitative aspects should also be integrated in the ICAAP process. We welcome this, as well as the considerations considering the individuality. Nevertheless, we believe that a listing of the most important aspects would enhance the certainty for credit institutions.

Regarding section VIII (f), the ESBG shares the view that the "residual risk in CRM" should not be addressed in Pillar II, being already sufficiently taken into account via the existing hair cuts and the very conservative way in which securities are treated in the credit risk mitigation framework in Pillar I.

Specific remarks on "section 5 – Supervisory Review and Evaluation Process"

Principle X indicates that the "*supervisory evaluation should be formally reviewed at least on an annual basis*". The ESBG does not believe that a mandatory annual review of the supervisory evaluation is appropriate for all credit institutions, regardless of their size, complexity or risk profile. Furthermore, a distinction should be made between on-site and off-site supervision: the mandatory annual review should not necessarily apply to on-site supervision, bearing in mind that supervisors also have limited resources; some supervisors might consider that for some categories of credit institutions, an annual off-site revision might prove sufficient.

Further remarks

The ESBG believes that CEBS' consultation paper should bring clarity to further issues related to the Supervisory Review Process, such as the following ones:

[1] See the response of the European Savings Banks Group to CEBS' Consultation Paper on High Level Principles on Outsourcing (30 July 2004).

- A **complaint mechanism** for banks: if a supervisor reaches different conclusions in his evaluation than the institution, would it be possible for the bank to complain against the decision, and to whom? Furthermore, in such a situation, would the bank be given insight into the analysis performed by the supervisor?
- **Disclosure**: do supervisors have to make public all supervisory measures or other actions taken against an institution? The ESBG believes that systematic disclosure of all actions taken against banks could entail serious dangers for them, including unjustified cuts of credit lines by creditors and reputational damage. Furthermore, appropriate provisions must be foreseen so that supervisory disclosure is kept anonymous with regard to individual institutions. Along the same lines, anonymous information should not be attributable to individual institutions, a situation which could happen in concentrated markets with only a limited number of players.