

CEBS Consultation paper on technical aspects of diversification under Pillar 2 – CP20

Nick Lock

Chair of Pillar 2 Convergence Network
(P2CN)

CEBS

Committee of European
Banking Supervisors

Outline

1. Background and introduction
2. Nature and focus of the CP20
3. Structure of the CP20
4. Field testing and planned follow-up work
5. Questions and comments

Background and timeframe

- June 2007 – “Issues list” from the Industry Platform on Operational Networks mentions “recognition of inter-risks, inter-business and cross-border diversification”
- October 2007 – launch of the P2CN; agreement of work programme
- December 2007 – SON-P2CN workshop including discussion panel on diversification
- June 2008 – CEBS publishes for public consultation the paper on diversification
- **8 September 2008 – public hearing**
- 31 October 2008 – end of consultation period
- December 2008 – planned final endorsement of the document

Nature and focus of the CP20

- Focus on diversification effects within the economic capital models used for ICAAP purposes (part of SREP evaluation)
- Full appreciation of the firms' ownership of internal capital models and ICAAP – supervisors do not validate ECMs, but they have to understand them
- Focus on the supervisors – non exhaustive and non binding recommendations to supervisors
- Keeping in mind the general spirit of Pillar 2 and firms' ownership over internal processes, actual use of these recommendations is subject to supervisory “judgment calls”

Nature and focus of the CP20 (2)

- Overview of the areas of supervisory interest with respect to diversification arising from ECMs used for ICAAP purposes
- Intended for use in dialogue with banks (e.g. firm specific ICAAP-SREP dialogue) – a flexible tool for supervisors
- Provides a background and basis for evaluation of diversification effects rather than guidance on which (if any) should be accepted
- Emphasis on understanding the general qualitative controls and environment of diversification modelling

Nature and focus of the CP20 (3)

- Less coverage of quantitative approaches and anticipated level of model outputs
- Over-arching Principles largely derived from existing CEBS Guidelines (e.g. stress testing, internal model validation)

Structure of the CP20

- General principles / issues for supervisory consideration:
 - Methodology and documentation
 - Scope and structure of the model
 - Availability and quality of data series
 - Correlations
 - Vendor models and third party parameters
 - Reliability and conservatism of the methodology
 - Internal model validation
 - Governance, decision making process and reporting
 - Comparing and understanding Pillar 1 and Pillar 2 calculations, and possible differences

Structure of the Consultation paper (2)

- Annex lists possible questions to be used in an ICAAP-SREP dialogue on diversification arising from modelling
- The list of questions follows the same structure as the principles laid down in the main body of the paper
- The list is not exhaustive, and no indication is given as to the "correct" answers, nor of the relative priority that should be given to the different questions

Field testing of the approach and further work

- To date, supervisors have insufficient experience of actual claims for diversification on which to base good practice guidelines
- Field testing of the principles and questions will take place in the CEBS ECM examination project – early feedback has been already incorporated
- P2CN will be monitoring developments in the future – learning process for both firms and supervisors
- Possible further revision of the document in 2009, after the results of the ECM examination project and P2CN work on wider issues of ECMs

Immediate follow-up work

- Public consultations runs until **31 October 2008**
- Please send your written comments to the following e-mail address: cp20@c-eps.org
- Comments received will be published on CEBS' website unless respondents explicitly request otherwise
- Final version of the document will be available in December 2008

Questions and comments?

- General comments about the CP20 and supervisory approach chosen to address diversification effects

Questions and comments?

- Comments referring to Section 1 (General overview of the model) including:
 - 1.1 Methodology and documentation
 - 1.2 Scope
 - 1.3 Model structure and parameter estimation
 - 1.4 Vendor models

Questions and comments?

- Comments referring to Section 2 (Diversification parameters) including:
 - 2.1 Data/time series availability and quality
 - 2.2 Correlations
 - 2.3 Third-part parameters and data
 - 2.4 Statistical vs expert based estimates

Questions and comments?


- Comments referring to Section 3 (Reliability and conservatism of the methodology) including:
 - 3.1 Robustness, stability and conservatism
 - 3.2 Stress-testing
 - 3.3 Sensitivity analysis

Questions and comments?

- Comments referring to Section 4 (Internal model validation)
- Comments referring to Section 5 (Internal decision making process), including:
 - 5.1 Governance
 - 5.2 Decision making process and reporting

Questions and comments?

- Comments referring to Section 6 (Comparing and understanding results of P2 and P1 capital calculations), including:
 - 6.1 Feasibility
 - 6.2 Understanding differences between regulatory and internal capital numbers
 - 6.3 Addressing the differences
- Comments referring to Section 7 (Group dimension)



Thank you for active participation today!

Contacts:

CEBS - <http://www.c-eps.org>
cp20@c-eps.org

Nick Lock

nick.lock@fsa.gov.uk

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