



**Eurofi 2008 -
Thursday 11/09/08**

Session [7] - CROSS-BORDER BANKING GROUPS SUPERVISION: Key features of the revised Capital Requirement Directive: College cooperation

arrangements, Decision Making Processes, Supervisors mandate specificities, CEBS role and responsibilities.

The Panel

Moderators: **Jacques de Larosière & Daniel Lebègue**, Co-Presidents, Eurofi

Panellists: **Charlie McCreevy**, EU Commissioner for Internal Market & Services;

Kerstin af Jochnick, Chairwoman, Committee of European Banking Supervisors (CEBS);

Karl-Peter Schackmann-Fallis, Executive Member of the Board, German Savings Banks Association;

Ieke van Den Burg, MEP, Committee on Economic and Monetary Affairs, European Parliament

Georges Pauget, Chief Executive Officer, Credit Agricole SA;

Thierry Francq, Assistant Secretary Financial Sector, Treasury and Economic Policy Directorate General Finance, French Ministry for the Economy, Finance and Employment;

The Debate

Supervision of cross-border banking groups had been discussed at length over the last couple of years, said **Charlie McCreevy**, EU Commissioner for Internal Market & Services, starting with the adoption of the CRD in 2006, when the powers of the consolidating supervisors were significantly increased and colleges of supervisors were established for some groups.

At a conference on supervisory arrangements in June 2007, "most industry representatives felt that a 'lead supervisor' model and reinforcement of CEBS would create further efficiencies", with some participants suggesting moving towards a European system of financial supervisors. "We have listened to industry's plea for further efficiency. We have also listened to ministries of finance, central bankers and supervisors. Although efficiency is paramount, effectiveness of supervision and financial stability concerns remain key, especially in these times of market turbulence. Efficiency and stability go hand in hand," Mr McCreevy said.

The Commission planned to develop its policy on financial stability in a White Paper on early intervention tools for dealing with ailing banks to be published in 2009. There was consensus that colleges of supervisors were the best way to supervise cross-border banking groups and "my conclusions are that colleges should remain flexible so as to cater for different circumstances and different organisational structures". But clear objectives for colleges should be set, he said and there should be consistent application of requirements within banking groups, with no duplication of requirements and information requests.

"We have decided to reinforce the powers of the consolidating supervisor for two supervisory aspects, namely capital add-ons for subsidiaries (Pillar 2) and prudential reporting requirements," the Commissioner said. "We're aware that if colleges develop diverging approaches, we run the risk of further fragmentation of the internal market, and even within a Member State itself."

As a result, CEBS had to play a key role in ensuring consistency across colleges. While some people had advocated further changes, "I have advocated an evolution rather than a revolutionary approach. We also have to be pragmatic about what is achievable now. It is crucial we make progress on strengthening our supervisory co-operation.

"Maybe at some point in time in the future we will have some form of EU level supervision for the largest financial institutions. But I don't believe we have the necessary conditions today for such a fundamental change," he added. "I will be pressing Member States to agree on a well functioning College of Supervisors so we can address the most important and urgent needs in strengthening supervision of cross-border institutions.

In stress situations for cross-border bank, were co-operation arrangements between ministries of finance, central banks and supervisors fit-for purpose, he asked? "All member states operate some form of early intervention mechanism in order to handle a crisis in an ailing bank. But the nature of the measures differs across Member States. While speedy action may be critically important to the survival of the institution or to minimise costs, such differences have the potential to complicate or impair efficient cross-border crisis handling. The Commission is committed to addressing those issues in next year's White Paper on early intervention."

Supervision of the 47 cross-border banks in the EU was among the highest priorities for banking supervisors, said **Kerstin af Jochnick**, Chair of the Committee of European Banking Supervisors (CEBS). "We want to deliver convergence in European banking supervision, but there is no silver bullet. It requires a lot of hard work and we are putting in an enormous effort to achieve the convergence that is needed for effective supervision."

Nice, September 2008

THE THINK TANK DEDICATED TO FINANCIAL SERVICES IN EUROPE

11 bis, rue Mansart - 75 009 Paris - FRANCE - Tel.: +33 1 40 82 96 03 - Fax: +33 1 40 82 96 03 - www.eurofi.net

CEBS is building a European supervisory culture with the support of the national authorities through measures such as training for supervisory staff and its colleges of supervisors. "An evolutionary approach will gradually deliver convergence among European Supervisors and efficiency in the cooperation of supervision of cross border banks that is so much needed."

However, this was not all in the hands of supervisors. Indeed, supervision was perhaps the easiest part. "There is much to do on legislation of financial institutions, which is still divergent at a national level. For example, there are 100 national discretions on the CRD," Ms af Jochnik said.

There were also other areas where there was not enough harmonisation in legislation, including crisis resolution. The conference had heard many strong views on the need for changes in supervision in Europe and supervisors were moving forward "and we will deliver more than you can see today". Changing financial supervision in 27 countries was like "changing a Skoda into a Volvo – it takes time. It won't happen overnight but we will deliver convergence."

Another issue was the need for harmonisation of deposit insurance schemes and lender of last resort. "We also need a clear mandate for national supervisors to have a cross-border perspective. We have not seen any such mandate in any member state. It is extremely important that national supervisors have the support at home and the necessary resources".

Some colleges of supervisors such as the ones at Nordic region were working very well, Ms af Jochnik said. The existing CRD required close co-operation and fosters the information exchange and the proposed amendments, which CEBS welcomed, further underlined this. The committee was setting up a peer review mechanism on how member states implemented CEBS guidelines and a mediation mechanism was in place for settling disputes among supervisors. There would also be a joint reporting scheme in place by 2012.

"Supervisors are moving at speed. There will be changes in the way cross-border banks work and their relations with home and host supervisors and this will have a substantial effect on cross-border supervision," she added.

A level playing field was essential when it comes to supervision, said **Karl-Peter Schackmann-Fallis**, Executive Member of the Board, German Savings Banks Association. "Some problems can only be solved by establishing a common supervisory culture and standards."

There are three core principles to adhere to in looking for more supervisory convergence.

- Enforcing the guideline "same business, same risk, same rules"
- Safeguarding and sustaining supervisory structures that are close to the market
- Limiting the supervisory burden and red tape

Several years ago, the German Savings Banks Group advocated already establishing colleges of supervisors to foster common supervisory practices and this was now set to be incorporated into EU legislation through changes to the CRD, while Commission proposals would also strengthen the role of CEBS. "Another step in the same direction is the implementation of Qualified Majority Voting within all Level 3 committees."

The Commission proposals were a step in the right direction, Mr Schackmann-Fallis said. "All this should take place in a European framework but for cross-border institutions, different supervisory practices and different reporting schemes are too burdensome." Common standards and a common technical basis would help to cut administrative burdens on supervisory reporting.

"Supervisory practice and a common supervisory culture are what would really help cross-border banks to solve their problems, not a debate on structural changes in banking supervision."

The aim should be to make cross-border banking supervision more efficient without losing closeness to the market. "I acknowledge that it was a useful decision to make the Consolidating Supervisor responsible for the approval processes of internal risk assessment methods and procedures of Basel II (pillar 1). Nevertheless the experience gained from this instrument should be analysed and evaluated before thinking of extending the rights of the consolidating supervisor. This is an element where we disagree with the Eurofi paper," he added.

"Any possible extension should be geared to the needs of daily supervisory practices on cross-border banking groups and an extension should always be limited to areas in which supervisory requirements can be addressed solely at a group level."

There are two approaches to the future of European banking supervision that had been widely advocated – the idea of a lead supervisor and a central banking supervisory authority. "I doubt whether either of these could be a solution for the problems cross-border banking groups in particular are facing. There are still too many conditions that have not been met, such as level playing field issues; the question of which authority is in charge in the case a bank goes bankrupt; who is responsible for bail-out activities and who is the lender of last resort."

Nice, September 2008

"Therefore I venture to say - establishing supervisory convergence via a common European Supervisory culture is the key to the solution. It cannot be imposed by directive but only achieved by day-to-day co-operation

Ieke van Den Burg, MEP, Committee on Economic and Monetary Affairs, European Parliament, harked back to Tommaso Padoa-Schioppa's comments in an earlier session about the amount of time ministers devoted to supervisory issues. "He said that ministers are not interested. I agree that this is the case."

The work that had been done by supervisors was all the more remarkable, and it was not true that supervisors did not think there was any need for a change. "They have done a lot of work to try to create convergence of practices. We should not blame supervisors for lack of progress."

Instead, the problem was that there was a lack of national mandates that incorporated a European dimension and that policy makers did not want to be unpopular with markets by diluting the role of national interests in decision-making. "That is much more of a barrier to progress than the supervisors," Ms van Den Burg said.

The 47 cross-border banks were global players and they wanted strong public counterparts so "we should act at the European scale, then we can have a voice and an influence in preventing crisis. We really have to cross these national borders and national interests by acting at a European level." If there had been closer co-operation between supervisors in Germany and the Banque de France, it could have helped the latter to deal with the problems at Société Générale.

Sectoral divisions should also be bridged, the MEP said, because many groups were not involved purely in banking, insurance or securities. The European Parliament was looking for solid proposals to improve the current system from Commissioner McCreevy by giving the Level 3 committees more power over the colleges of supervisors

Closer links between micro and macro-prudential measures were also needed, she added. "The ECB has done a marvellous job with the restricted information available to it – if it had had better information, it could have intervened earlier."

Europe could be stronger if it was not restricted by national perspectives, as was the case in the UK. "It is at the European scale that we can really have a voice and some influence."

Newer member states, whose financial systems were dominated by global financial groups, would not be well served by a focus on lead supervisors, she concluded. "Citizens in these states do not trust supervisors from another member state to operate in their interests."

There were two main challenges, said **Georges Pauget**, Chief Executive Officer, Credit Agricole; cross-border banking group supervision and the interplay between supervisory authorities and their capacity to co-ordinate

efforts in systemic crises. "Internationally active banks are still confronted with a very fragmented supervisory system, based on a multitude of specific national requirements and reporting bodies. For Crédit Agricole alone, we have 14 members in our Supervisory College."

Diverse legal frameworks, deposit guarantee schemes, fiscal regimes and national supervisory arrangements within the EU hampered effective and efficient cross-border banking supervision in Europe but change was under way. The establishment of the Level 3 committees of supervisors addressed some of the industry's concerns and contributed to supervisory co-operation and convergence and the introduction of experimental supervisory colleges had also been important.

"However, whilst this experience has contributed to a more co-ordinated approach in supervisory practices across the EU, divergences among regulators persist, revealing the limits of purely inter-governmental soft-law approach," Mr Pauget said. "We favour the step-by-step approach outlined by a number of industry associations and well reflected in the seven principles of supervision put forward today by Eurofi."

The Capital Requirement Directive should be amended so that each cross-border banking group was supervised by colleges of supervisors overseen by a lead supervisor, which should be the home supervisor of the parent company. "The College would comprise all supervisory agencies in whose jurisdiction the financial institution has sizeable operations. Since a majority of the large banking groups also operate globally, the composition of the college could be extended to non-EU supervisors," he added.

The lead supervisor would be the single point of contact for the financial institution in question and the sole authority for all matters of prudential supervision at the level of the group and its constituents, Mr Pauget proposed. The lead supervisor would draw on the expertise and knowledge of local supervisors and entrust tasks to them by means of the delegation of tasks and, where appropriate, responsibilities. A mediation mechanism would be available in the case of disagreement. In parallel, national supervisors should be required, as a part of their mandate, to co-operate with their European counterparts.

Turning to the effective interplay between supervisory authorities and crisis management, "the financial turmoil has revealed the strong interlinkages between financial markets worldwide as well as the size of cross-border groups' financial operations". This meant that the failure of an individual large financial group was increasingly likely to have systemic effects. "Europe must stand ready to address these situations by reinforcing co-operation among supervisors and setting up strong and sustainable crisis management mechanisms," he said. Crédit Agricole welcomed the recent adoption by EU supervisors of an extended Memorandum of Understanding for enhanced co-operation, including on the sharing of fiscal burden.

Nice, September 2008

The case of Northern Rock suggested a need to revisit the issue of deposit guarantee schemes in the EU. Initially, this directive was designed to operate on the basis of minimum harmonisation. "This is clearly not sufficient anymore. Recent events have shown the need for more harmonised and interoperable deposit guarantee schemes across the EU. This is key to rebuilding market confidence," Mr Pauget said.

The French presidency had strongly emphasised the importance of group supervision, not just to make supervision more efficient but also more effective, said **Thierry Francq**, Assistant Secretary Financial Sector, Treasury and Economic Policy Directorate General Finance, French Ministry for the Economy, Finance and Employment. "This is even more important today because we have seen that fragmentation of supervision is dangerous."

While there was a recognition that progress must be made, some fears remained. It was essential to retain a local view, with supervision remaining close to the market, but global groups also required a global view, and this was one of the aims of the colleges. While it might only be a question of cultures, the issue was how to create a convergence of cultures and some impetus from legislation was necessary, Mr Francq said.

The changes to the CRD that many saw as evolutionary were actually revolutionary, he argued, because they gave home supervisors the final say. In practice, there had been good progress with no need to use the final say provision, so the changes had contributed to an enhanced convergence of views. "Why not use this same process in other areas?" Mr Francq asked.

The issue of a level playing field remained important when different groups co-existed in the same market, which made the "umbrella" of the Level 3 committees important.

"We have all the elements in place to make some progress, but we know there are still some issues to deal with, such as how to organise more co-operation between central banks and supervisors," he added.

Nice, September 2008

THE THINK TANK DEDICATED TO FINANCIAL SERVICES IN EUROPE

11 bis, rue Mansart - 75 009 Paris - FRANCE - Tel.: +33 1 40 82 96 03 - Fax: +33 1 40 82 96 03 - www.eurofi.net