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**DIRECTORATE-GENERAL INTERNAL POLICIES OF THE UNION  
- DIRECTORATE A -  
ECONOMIC AND SCIENTIFIC POLICIES**

**Workshop: CRD Revision in the light of the financial crisis**

**05 November 2008**

European Parliament, Brussels, Room: **PHS 4 B001 15.00-18.30**  
**(Interpretation DE, EN, FR)**

15.00-15.05 **Introduction by ECON Chairwoman, Ms Pervenche Berés**

15.05-15.10 Introduction by MEP Mr Othmar Karas, Rapporteur CRD

15.10-16.45 **Session 1: Is the current prudential regime for the EU banking sector, based on Basel II, fit for purpose?**

- Is the Basel II/CRD risk management approach appropriate today (e.g. is its reliance on (i) credit rating agencies and (ii) bank's own economic models to determine prudential capital appropriate?) ?
- Is the Commission proposal an adequate response to the crisis?

**Guest speakers:**

- Dr Rym Ayadi, Head of Financial Institutions and Prudential Policy Unit, CEPS, Belgium
- Dr Hugo Banziger, Chief Risk Officer, Deutsche Bank, Germany
- Ms Barbara Frohn, Global Head of Internal Model Validation, Banco de Santander, Spain
- Mr Gerhard Hofmann, Board Member of the Bundesverband der Deutschen Volksbanken, Germany

16.45-18.30 **Session 2: EU supervision-What is the right approach?**

- Are the CRD changes the right approach for banking?
- Is there consistency with the Solvency II model?
- How to resolve the home/host issue/dilemma? Can colleges of supervisors be a final solution? What should be the future of Level 3 Committees?
- How should the supervision be designed with regard to financial stability and crisis management? Drawing lessons from the current financial crisis and the rescue of xborder banking groups how can a more formal cross border rescue operation be set up? Should the ECB as some argue have a more dominant role?

**Guest speakers:**

- Mr Nicolas Peligry, Deputy Head International Affairs Division, Banque de France, France
- Mr Thomas Huertas, Banking Sector Director, FSA, UK
- Mr Andreas Ittner, Member of the Governing Board, ONB, Austria
- Mr Mauro Grande, Director, Directorate Financial Stability, ECB
- Mr David Wright, Deputy Director-General, DG Markt, European Commission

**Discussants for the two sessions: (co authors, together with Prof. John Eatwell and Mr Avinash Persaud, of the study prepared for the ECON Committee of the European Parliament on "Financial supervision and Crisis Management in the EU"):**

- Prof. Kern Alexander, University of London Centre for Commercial Law Studies, and the Centre for Financial Analysis and Policy, Judge Business School, University of Cambridge, UK
- Mr Robert Reoch, New College Capital Ltd; UK

# **Curricula Vitae**

## **Session I - Speakers**

### **Rym Ayadi**

Dr. Rym Ayadi is Senior Research Fellow and Head of Research of the Financial Institutions, Prudential Policy and Tax Unit at the Centre of European Policy Studies. Rym has been working on financial services, financial markets and regulation areas in Europe over the past ten years. She is expert member of FIN-Use forum, an independent expert forum set by the European Commission on financial services matters from users' perspective and invited expert in several research projects on her areas of expertise. She is also "Rapporteur" for several high-level CEPS working parties, which are chaired by senior officials and executives, and attended by business representatives and officials. She holds a PhD in economics and finance at the University Paris Dauphine. She is author of several books, papers and policy briefs on financial regulation (e.g. Basel II, Solvency II), SME financing, banking mergers & acquisitions and European financial markets integration....

### **Hugo Banziger**

Hugo was appointed to the Deutsche Bank Management Board in May 2006 as the Chief Risk Officer. He is responsible for Credit, Market and Operational Risk, as well as Corporate Security & Business Continuity, and Treasury. In May 2007 he also assumed responsibility for Legal and Compliance. In 2000 he became DB's Chief Credit Officer and assumed responsibility for Operational Risk Management in 2004. From 1985 to 1996 Hugo worked at Credit Suisse Group. In 1990, Hugo was appointed Global Head of Credit for Credit Suisse Financial Products, the derivatives house of Credit Suisse Group, based in London. In 1983 he started his career at the Swiss Federal Banking Commission, the Supervisory Agency of Swiss Banks. Hugo has a Doctorate in Economic History from the University of Berne, Switzerland.

### **Barbara Frohn**

As Global Head of the Model Validation group of Banco Santander Barbara Frohn assumes responsibility for the internal validation of Risk Models (Credit, Operational & Market Risk and Economic Capital models ) at a corporate level. In addition, Barbara Frohn is deeply involved in the discussions that are taking place between the different industry bodies and the European institutions and other national or supranational governmental organisations in relation to the development of financial regulation and the future of supervision. Preceding her move to Madrid, Barbara fulfilled during 15 years of employment at ABN AMRO various roles in a.o. Global Relationship Management, Energy Finance and Asset Securitisation. Lastly, she headed the Basel II Requirements & Strategic Advisory department within Group Risk Management.

### **Gerhard Hofmann**

Gerhard Hofmann is a board member of the BVR, the Federal Association of German Cooperative Banks, as well as a member of the Executive Committee of the EACB (European Association of Cooperative Banks). Before joining the BVR, he had worked for 21 years for the Deutsche Bundesbank, mainly in the areas of banking supervision and financial stability. At that time he was a member of the Basel Committee, of the BSC and CEBS. Mr Hofmann is the editor of a book on Basel II.

## Session II - Speakers

### Nicolas Peligry

Nicolas Péligré, 41, is currently Deputy head of international affairs division, at the French banking commission.

He started his career at the French banking Commission in 1996, in the supervision department (off-site and on-site inspection) and joined the French Treasury, Monetary and banking division in 2003 where he contributed *inter alia* to the preliminary discussions, at European Level, on the CRD.

He joined the International affairs division in mid-2005. He is member of several working groups of BCBS CEBS and worked as senior advisor to Mrs. NOUY during the French presidency of the latter committee (2006-2007).

### Thomas Huertas

Thomas Huertas is Banking Sector Director of the FSA, a role specifically created to enable the FSA to deliver the Tripartite authorities' initiatives to improve the regulatory architecture of the banking industry. Prior to that, Thomas was acting Managing Director of Wholesale and Institutional Markets at the FSA. Reporting directly to Hector Sants, CEO, Thomas is responsible for improving the depositor and resolution regime for troubled banks, implementing appropriate changes in the liquidity framework for banks, strengthening the FSA's risk identification and mitigation capabilities in the banking sector and improving the FSA's resolution capabilities. He has extensive practical experience in banking and finance from his career with Citigroup, joining in 1975 and holding a number of senior positions. He worked on regulatory issues and corporate strategy in both the United States and Europe as the Chief of Staff for the Vice Chairman. From 2001 to 2003, Thomas was Chief Executive of Orbian, a trade finance and settlement company. More recently, Thomas was Managing Director of Citigroup Global Transaction Services. In addition, he has published and lectured extensively on financial regulation. He holds a PhD in Economics from the University of Chicago.

### Andreas Ittner

Member of the Governing Board, Oesterreichische Nationalbank

Professional Activities:

since Sept. 2008	Member of the Governing Board of the Oesterreichische Nationalbank Financial Stability, Banking Supervision and Statistics
since 1983	Oesterreichische Nationalbank: 11 years Director of the Financial Stability and Bank Inspections Department 10 years Head of the Secretariat for the President of the OeNB

Other Functions:

Member of the Committee of European Banking Supervisors (CEBS)

Acting Member of the Banking Supervision Committee of the ESCB (BSC)

Chairman of the Task Force on Liquidity Stress Testing & Contingency Funding

Member of the Supervisory Board of the Austrian Financial Market Authority (FMA)

Member of the Financial Market Committee established under the Austrian Financial Market Supervision Act

## **Mauro Grande**

Born in 1958 in Bolzano (Italy). In 1983 he joined Banca d'Italia and until 1990 he worked in several areas of the Banking Supervision Department of Banca d'Italia. In 1991-92 he was seconded as a national expert at DG XV of the European Commission (Securities Markets Division). At the end of 1994 he was seconded to the European Monetary Institute as Secretary of the Banking Supervisory Sub-Committee. In June 1998, he was appointed Head of the Prudential Supervision Division at the European Central Bank (ECB), in charge of carrying out the tasks of the ECB in the fields of prudential supervision and financial stability. Since February 2003, he is Director and responsible for the area Financial Stability and Supervision of the ECB."

## **David Wright**

David Wright was born in England in 1951. After studying PPE at Oxford, he has been employed by the European Commission since 1977. His career within the Commission has included working in the Statistical Office (1977-1982), the Directorate General For Energy (1982-1987), the Directorate General for Industry and Internal Market Affairs (1987-1989), as Adviser in President Delors' Forward Studies Unit (1989-1992), as a Member of the Cabinet of Sir Leon Brittan Q.C., Commissioner responsible for External and Economic Affairs (1993-1995), as Adviser to Jacques Santer, President of the European Commission (1995-1999), as Director of Financial Services Policy and Financial Markets, and currently as Deputy Director General of DG Internal Market and Services.

## **Discussants**

### **Kern Alexander**

Kern Alexander is Professor of Law and Finance at the University of London Queen Mary College and is Director of Research in Financial Regulation at the Centre for Financial Analysis and Policy, University of Cambridge. Professor Alexander is co-author with Professor John Eatwell of Global Governance of Financial Systems published by Oxford University Press and is a co-author of the European Parliament commissioned report entitled: 'Financial Supervision and Crisis Management in the EU'. He presently is advising the European Commission on the implementation of Basel II in China on the 'EU-China Trade Project.

### **Robert Reoch**

Robert Reoch has over 20 years of experience in finance and has been involved in the credit derivatives market since setting up J.P. Morgan's business in 1994. Reoch Credit Partners was established in 2001 to provide a range of advisory, quantitative, transactional and training services to the market. Robert holds a degree in Chinese Studies and in Law from Cambridge University.

# Slides



**Session I - Is the current prudential regime for the EU banking sector, based on Basel II, fit for purpose?**

Presentation by

**Rym Ayadi**  
**CEPS, Belgium**



## Challenging the New Basel Consensus

*Dr. Rym Ayadi, Senior Research Fellow and Head of Financial  
Institutions and Prudential Policy Unit, CEPS, Brussels*

Brussels, November 5, 2008

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### Key Ratios for Top 5 Banks

2007	Top 5 bank assets as % of GNP	Loans to deposits	Core capital ratio	Basel 'tier 1' ratio
Belgium	463	104	4	
France	293	101	3.5	7.4
Germany	165	94	2.6	8
Ireland	404	197	3.6	
Italy	131	161	7.4	6.6
Netherlands	521	125	3.8	10
Spain	184	250	7.2	7.9
UK	313	125	3.9	7.6
<b>EU 27</b>	<b>237</b>	<b>133</b>	4.3	
Switzerland	756	69	3.2	9.8
<b>USA</b>	<b>44</b>	<b>91</b>	7.6	8

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## Key Ratios for Top Banks

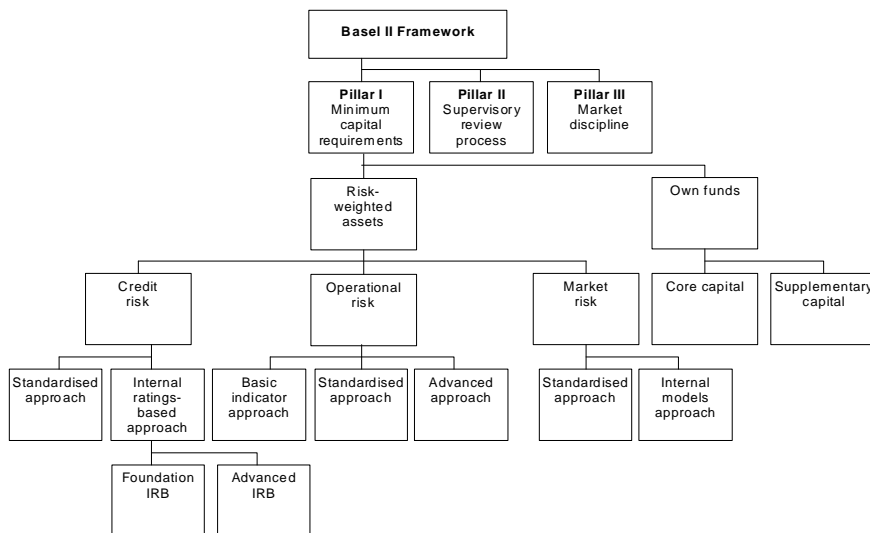
	Basel Tier 1 ratio		Core capital	
	end 2007	June-08	end 2007	June-08
Fortis	9,5	7,4	3,8	3
Dexia	9,1	11,4	2,4	1,6
ING	7,4	8,4	2,8	2,2

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## Is the Current Framework of Basel II the Answer?



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## Is the Current Framework of Basel II the Answer?

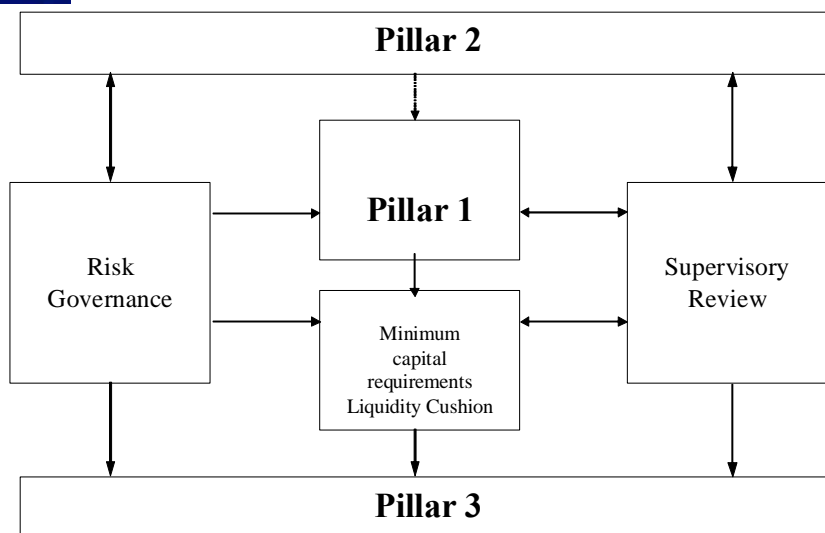
- Does not consider the **interaction between risks**
  - **Limited approach** to regulate today's banking businesses
- Relies on **internal risk assessment and management systems** of major banks and risk assessments of **external rating agencies**:
  - Both have been shown to have **considerable flaws**
  - More **perverse incentives** and **regulatory arbitrage** under Pillar 1
- The revised rules for counterparty credit risk and double default do not reflect credit risk exposures held in the trading book
- Does not reflect **liquidity risk**
- Weakness in risk delimitation
- **Weakness of interaction between 3 pillars**

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## An Integrated Approach of Capital and Liquidity Regulation is Essential



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## A Regulatory Paradigm Shift is Needed

- Is Pillar 1 (as it stands now) the solution? Why should regulators rely on one indicator? Particularly if the calculation is flawed? Is a minimum required of 8% still valid?
- How can Pillar 2 be a remedy? How can it be strengthened?
  - Role of an independent centralized risk management function
  - Role of the Board and role of auditors
  - Dynamic capital management....
  - Strengthening the institutional role of CEBS
- How should Pillars 2 and 3 interact ?

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### Contact Details

Dr. Rym Ayadi

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Brussels, November 5, 2008

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## CRD – Fit for Purpose?

**Workshop: CRD revision in the light of the crisis  
Brussels, 5 November 2008**



**Dr. Hugo Banziger**  
Chief Risk Officer

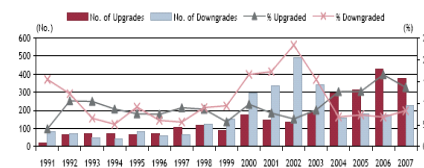
A Passion to Perform. **Deutsche Bank**

### Question 1: Excessive CRD reliance upon CRA ratings and banks' internal economic capital models?

Benefits of reliance upon CRAs by far outweigh drawbacks:

- External CRA ratings make capital requirements significantly more risk-sensitive than under Basel I
- Under Basel II/CRD, CRA ratings are translated into differentiated risk weightings which are reflective of changes of credit quality over time
- CRA ratings (in particular for European / corporate assets) have reasonably stable track record over time

Fitch Global Corporate Finance Historical Ratings Changes<sup>a</sup>



<sup>a</sup>Compares beginning-of-year rating with end-of-year rating; does not count multiple rating actions throughout the year. Source: Fitch.

**N.B. As DB uses Internal Ratings Based Approach, external ratings are less relevant**

Basel II/CRD pillar 1 capital requirements NOT based upon banks' internal EC models

- Models for calculation of pillar 1 capital requirements are subject to supervisory approval and detailed quantitative and qualitative requirements
- Internal EC models are not - supervisors can impose capital add-ons based upon EC models' output, if EC models are used for pillar 2 Internal Capital Adequacy Assessment Process

## Question 2: Are Commission proposals an adequate response to the crisis?

### Supervisory arrangements

- Colleges of supervisors under strong process leadership of consolidating supervisor with final say on group-wide Pillar 2 and reporting

✓ Operat. integration of group-wide supervision is a must BUT: crisis demonstrated integrated markets require full institutional integration

### Liquidity Risk

- CRD implements CEBS and BCBS work - use of sophisticated internal methodologies allowed

✓ Much improved regulat. framework providing flexibility for supervisory responses to crisis

### Securitization

- EU-regulated banks cannot invest into a securitization exposure, unless originator/sponsor retains at least 5% "net economic interest"

✗ Impediment to the re-opening of the securitization market; does not focus on the economic risk in the transaction

### Large exposures

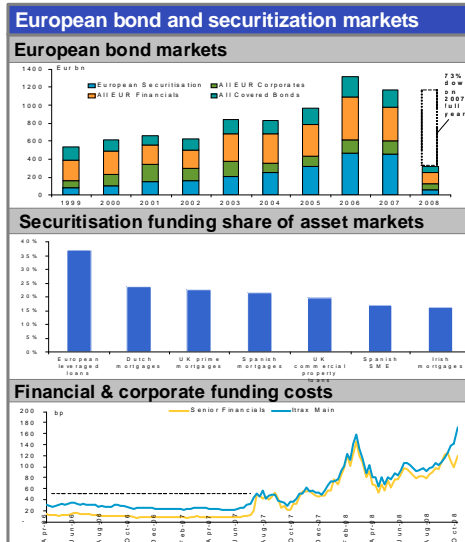
- Definition of "connected clients" extended to include common "funding or repayment difficulties"
- Unsecured inter-bank exposures limited to 25% of own funds or an alternative threshold of EUR150m (whichever is higher)

✗ Overly extensive definition of connected clients, potentially resulting in funding problems

✗ Puts significant further strain on currently disrupted inter-bank liquidity market

## Commission proposal on securitisation is harmful in the current economic environment

- Securitisation plays key role in bringing back liquidity to EU credit markets
- Revival of securitisation will stabilise markets and restore flow of credit to households and corporates
- However, current Commission proposal:
  - Forces banks to retain concentrated risk positions
  - Reduces availability and increases cost of credit in EU
  - Damages EU securitisation markets as a source of funding
  - Impedes EU banks' ability to compete globally in credit markets
- An appropriate regulatory response is needed to:
  - Prevent past excesses
  - Restore credit liquidity



## Commission proposal on Large Exposures puts further strain upon disrupted inter-bank liquidity markets

### Liquidity

Reduces liquidity in inter-bank markets, already under strain

### Competitive distortion

Puts EU banks at a competitive disadvantage to US banks

### Derivatives business

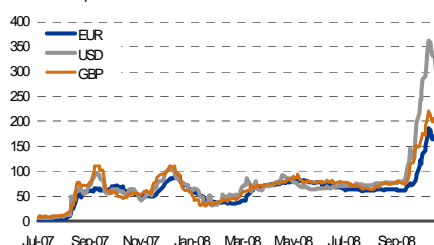
Disrupts and drives inter-bank derivatives business away from the EU

### Medium-size banks

Reduces medium-sized banks' access to the inter-bank lending market

### Dramatic liquidity squeeze in money markets

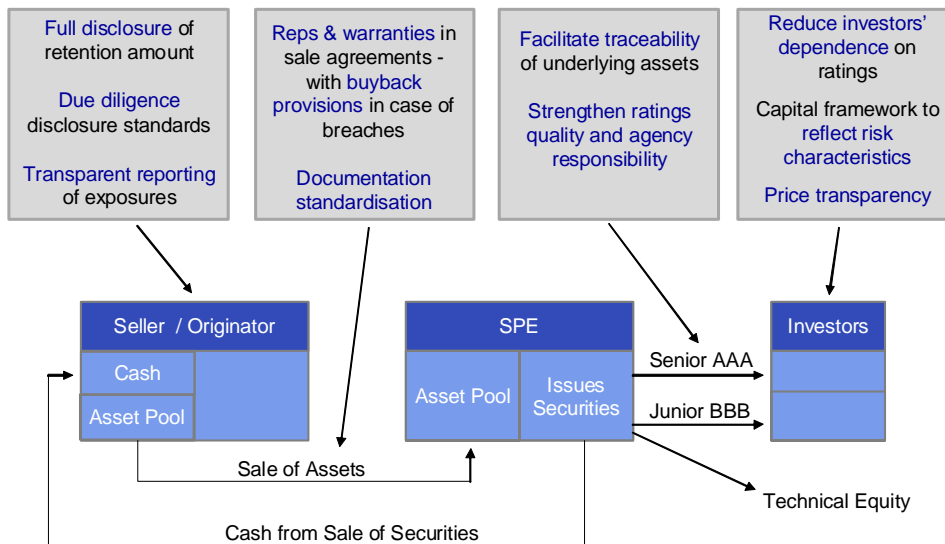
3M Libor OIS spreads



Disruption of inter-bank liquidity markets during crisis suggests:

Exemption for inter-bank exposures with contractual maturity = 3 months should be retained

## Fit-for-purpose regulatory response



**Presentation by**

**Barbara Frohn**

**Global Head of Internal Model Validation**

**Banco de Santander, Spain**



**Workshop: “CRD Revision in the light of  
the financial crisis”**

**Session 1.- Is the current prudential regime for the EU  
banking sector, based on Basel II, fit for purpose?  
The Santander perspective**

**Barbara Frohn**

**European Parliament, Brussels  
November 5, 2008**



## 01. In the light of the crisis....

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- **Systemic risk and contagion effects have been at the forefront of the crisis** → Responses to the crisis should have a global reach but without “*de facto*” killing the financial markets nor penalizing well-performing market players and sound market practices.
- **The decisions of today will shape the financial system of tomorrow.** Therefore, we should keep in mind that regulations may solve the current situation but can imply barriers for the future.
- **The creation of a true level playing field is a pre-requisite for market stability** in the short term (the new state-controlled banks!) and in the medium term (both within and outside the scope of the CRD)
- The future of bank supervision: a delicate balancing act between
  - more focused supervision versus additional layers of regulation
  - solvency and consumer protection



## 02. Is reliance on internal models justified?

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- **Santander's** internal rating models capture and signal a client's creditworthiness through the cycle and provide estimates of loan losses at the lowest point in the cycle. Use test requirements ensure business awareness and risk based pricing which is crucial in a recessionary climate.
- Economic Capital Models are powerful instruments for portfolio, risk and capital management *provided* its users take full account of model limitations and model risk; they can be deployed for stress testing and scenario analysis and hence support management decision making and management intervention
- **EC models are not the panacea. An EC model** is one tool out of a wide range of risk management tools and processes, and represents just one component of a bank's comprehensive ICAAP



### 03. Will the revised CRD be fit for purpose?

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Many changes are deemed positive by the banking community as the amendments align more closely with standing business practice and:

- Tackle issues that were left open (e.g. L.E., Hybrids)
- Remedy inconsistencies (leasing)
- Confront the current financial turbulence

But some issues remain pending. Aiming at market stability and financial institution soundness the CRD will be an effective tool provided these pending issues are properly addressed:

- Full recognition of DIVERSIFICATION in EC models
- Joint IFRS and Basel II effect: procyclicality and capital volatility → **dynamic provisioning**
- Regulatory and supervisory convergence (National Discretions)
- Limited scope of influence of the CRD

..and with the right focus on Pillar 2:

If used to its full potential, Pillar 2 provides the requisite basis for the bank-supervisor dialogue on a bank's business model, its resilience in times of stress, its capital strength as well as its capacity to instil confidence in depositors and investors.



### CRD revision (1) : Large Exposures

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**Santander** fully acknowledges the need to manage and closely monitor client & other concentrations

However:

- In the current climate, impeding on a free flow of liquidity in the interbank market may prove counterproductive
- The application of the LE regime at subsidiary level poses problems:
  1. esp. for local currencies the number of trusted counterparties may be limited
  2. intragroup: it goes against sound and prudent ALM practices to put excess cash with the parent bank and to issue SBL/Cs ifo subsidiaries. **This defies the objective!**
  3. unlevel playing field between domestic and foreign subsidiaries
- Connected clients (i.e. economic dependence): prudential benefits do not outweigh costs; multiple interpretations lead to confusion

**Santander supports:**

- A light regime for interbank exposures, exemption for intragroup exposures, however coupled with supervisory scrutiny of a bank's internal liquidity management practices in Pillar 2
- A two tiered model for interconnectedness: < 20% of own funds: internal notion of client group  
> 20% (reporting) obligation to investigate interconnectedness



## CRD revision (2) : Asset Securitisation

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Securitisation provides a vital funding source for financial and other industries.

**Common Goals:** Restart of a healthy, fully transparent securitisation market, capitalisation commensurate with securitisation risks incurred

The revised CRD brings about **improvements** in certain areas (e.g. Significant Risk Transfer)

However, **could have negative repercussions in others (Art 122<sup>a</sup>)**:

*More than anything, contagion effects caused the crisis to spread to the EU securitisation and covered bonds markets. Many EU banks kept their first loss position already on their books and had proper lending standards in place for assets to be securitised.*

- Is a European solution to a global problem
- Unintentionally impacts on non-securitisation transactions required for sound capital management (e.g. CDS protection)
- Leads to confusion due to lack of clarity (e.g. scope, 'net economic interest')
- Creates an ongoing obligation which is technically impossible to comply with
- Includes a retention obligation for agents and brokers that have little involvement
- Shies away potential investors, brokers and agents
- Thereby effectively kills the possibility of a re-start of the securitisation markets



## CRD revision (2) : Asset Securitisation

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**Santander**, even though not directly affected by a retention obligation, still opposes art 122a.

**Santander** supports industry initiatives aimed at achieving the common goals:

- Alternative solutions (ESF/SIFMA, Dutch initiative) representing a responsible alignment between originator and investor interests
- Additionally, the industry advocates strengthening of the securitisation practice / OTD model: reps & warranties, enhanced disclosure, uniformity of standards and disclosure practices



## CRD revision (3) : Supervisory Structures

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**The new supervisory arrangements represent a step in the right direction:**

- Enhancement of supervisory convergence and co-ordination
- Further and better understanding of a large bank's overall risk profile and its centralised processes
- Increased efficiency and alignment through the expansion of the scope of art 129 and by the formalisation of the College of Supervisor model

**However:**

- Currently, supervision is still primarily bilateral. There is **still a long way to go**.
- The introduction of the notion of **systematically relevant branches** and the powers invested in branch supervisors may well prove unworkable, esp. in crisis situations

**Santander supports:**

- A two-level college model, Core College vs. Full College
- More consideration should be given to supervisory co-operation in stress versus going concern situations
- Strengthening the burden of proof for a claim under art. 42.1



## Annex: Santander Profile

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The crisis has taught us that mechanisms to monitor and evaluate information are as important as transparency among financial institutions.

## Santander profile: international

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### International profile



**Europe.** Santander has presence in:

- |                                      |   |
|--------------------------------------|---|
| <input type="checkbox"/> Spain       | <input type="checkbox"/> Poland         |
| <input type="checkbox"/> UK          | <input type="checkbox"/> Czech Republic |
| <input type="checkbox"/> Portugal    | <input type="checkbox"/> Austria        |
| <input type="checkbox"/> Italy       | <input type="checkbox"/> Hungary        |
| <input type="checkbox"/> Germany     | <input type="checkbox"/> Norway         |
| <input type="checkbox"/> France      | <input type="checkbox"/> Sweden         |
| <input type="checkbox"/> Netherlands | <input type="checkbox"/> Finland        |
| <input type="checkbox"/> Switzerland | <input type="checkbox"/> Russia         |
|                                      | <input type="checkbox"/> Slovakia       |

**Latin America.** Santander also conducts businesses in:

- |                                    |                                      |
|------------------------------------|--------------------------------------|
| <input type="checkbox"/> Brazil    | <input type="checkbox"/> Venezuela   |
| <input type="checkbox"/> Mexico    | <input type="checkbox"/> Puerto Rico |
| <input type="checkbox"/> Chile     | <input type="checkbox"/> Colombia    |
| <input type="checkbox"/> Argentina | <input type="checkbox"/> Uruguay     |

**USA.** Through Drive Financial

**In the past twenty years we went from having 75% of total profit in Spain to a 44%**



**The global scope achieved by Santander is the result of great international vision, as shown by the Group's presence in a large number of countries.**

**One fact that clearly reflects this international scope is that three of each four employees who today work in the Group do so outside Spain.**

**This international vision follows a well-defined strategy, which focuses the Group's activity on Europe and Latin America, and especially in those countries and businesses with the greatest growth potential. Drive's acquisition has positioned us in the biggest consumer market in the world, USA**

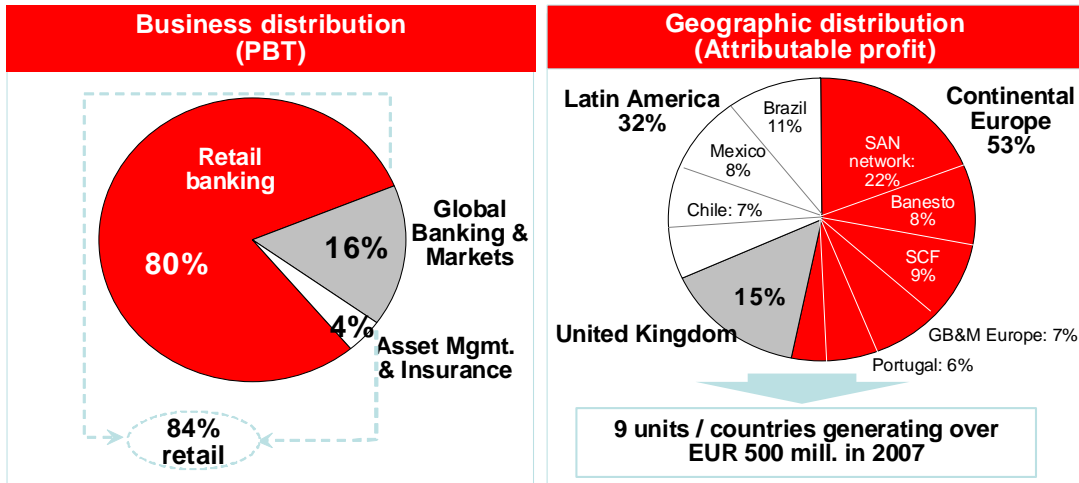
Noteworthy is the fact that in the last twenty years we went from having 75% of the total profit in Spain to having the 44%.

## Santander profile: retail banking focus

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Strong geographical and business area **diversification**: retail banking focus

### Attributable profit by operating business areas\*



(\*) Data as of December 2007



2.- HIGH LEVEL of DIVERSIFICATION by both geographic area and business line

By **geographic area**, **Continental Europe** accounted for almost **one half of revenues** in 2007, with **Latin America** generating over **one third** and the **United Kingdom (Abbey)** accounting for **rest**.

By **business**, our group is focused on **retail banking**, where we generate **84% of profit before tax**. We also have **global areas** that generate income and profits either directly in the “**factories**” or indirectly through the **commissions** passed through to the networks.

Lastly I would like to emphasize the substantial diversification by business unit, as **nine of them generated profits of more than EUR 500 million**. This is clearly one of the keys to the **consistency and soundness of our revenues**



**Presentation by**

**Gerhard Hofmann**

**Bundesverband der Deutschen Volksbanken, Germany**



## **Is the current prudential regime for the EU-Banking sector, based on Basel II, fit for purpose?**

**Gerhard Hofmann**

**Federal Association  
of German Cooperative Banks ?BVR**



## **Co-operative Banks in the EU**

- 4.500 Co-operative Banks in Europe
- 45 Million Members and shareholders
- 140 million clients
- Presence in 20 European Countries





## Is the Basel II/CRD approach appropriate?

- Hard empirical evidence on effectiveness of CRD/Basel II not yet available:
  - Basel II/CRD has not yet been fully implemented before the financial crisis was unfolding; only few institutions were on Basel II
  - USA are lagging behind
- Overall assessment of CRD:
  - CRD/Basel II are in principle appropriate ways forward
  - Risk sensitive framework is still the best option
  - However, by nature CRD is no panacea
  - Complementary measures in areas outside the core of banking regulation essential (fair value accounting, address shadow banking system, especially CDS, hedge funds, rating agencies, remuneration systems etc)

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05.11.2008 | CRD-Workshop | BVR | Gerhard Hofmann



## Is the commission proposal an adequate response to the crisis?

- Securitisation framework: Clear improvements through envisaged CRD amendments
- Originate-to-distribute model problematic
- Obligatory retained portion of securitisation tranches improves incentive structure...
- ...should, however, not be set too high as it would make risk transfer in general more difficult
- Moreover, qualitative requirements (i.e. stress testing etc) quite tight → smaller institutions will be constrained in their ability to diversify risk, principle of proportionality as a possible solution
- Scope should be limited to originate-to-distribute models, otherwise networks of co-operative banks and savings banks will lose their instruments to diversify risks within the respective network

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05.11.2008 | CRD-Workshop | BVR | Gerhard Hofmann





## Is the commission proposal an adequate response to the crisis?

### Proposed rules for large interbank exposures not fully convincing:

- Money markets may suffer
- Timing aspect: Financial crisis not yet over
- 150 million € threshold essential for small institutions to maintain access to money markets; relating this limit to bank internal procedures would create uncertainty
- Impact study recommended, also to ensure consistency with other jurisdictions

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## Is the Basel II/CRD approach appropriate?

### Further improvements necessary:

- Proper implementation of Pillar 2
  - Originate-to-distribute model needs more supervision
  - Avoid unreflected use of external ratings
  - Focus on systemic relevance (difficult to supervise, but most relevant)
  - Focus on off balance sheet exposures outside the radar screen of risk management, supervisory boards and auditors → bring back to balance sheet (Spanish and Italian example)
- Address credit default swaps (\$ 55 trillion market), US: central clearing house discussed; EU ?
- ...as well as other forms of shadow banking (US: initiating mortgages without banking license as a root cause of the sub prime crisis)

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## Is the commission proposal an adequate response to the crisis?

### Organisation of supervision in Europe

- Financial crisis not a convincing argument to jump to new institution(s) for overseeing the markets, financial intermediaries and financial infrastructure. Difficult political, legal and practical issues to resolve (after the crisis will be before the crisis)
- Strengthening Lamfalussy II: Cooperation of supervisory authorities in Europe still the optimum to achieve convergence and maintain financial stability
- Differences in national markets remain; avoid discrepancy between supervisory responsibility and accountability for/burden of bail-out
- Networks of cooperative and saving banks, which are among the few stabilising pillars in this crisis, should not be put at a competitive disadvantage by a new institutional structure of supervision

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## Is the commission proposal an adequate response to the crisis?

### Timing and consistency of regulatory responses on a global basis

- 15. Nov. 2008: global financial summit in Washington
- Some politicians propose wide ranging changes (role of IMF, substantive changes?)
- Level playing field must be maintained: Europe to play an important part and provide substantial input in new regulatory agenda, but no „stand alone“-solutions
- Will CRD amendments still make sense against global initiative?

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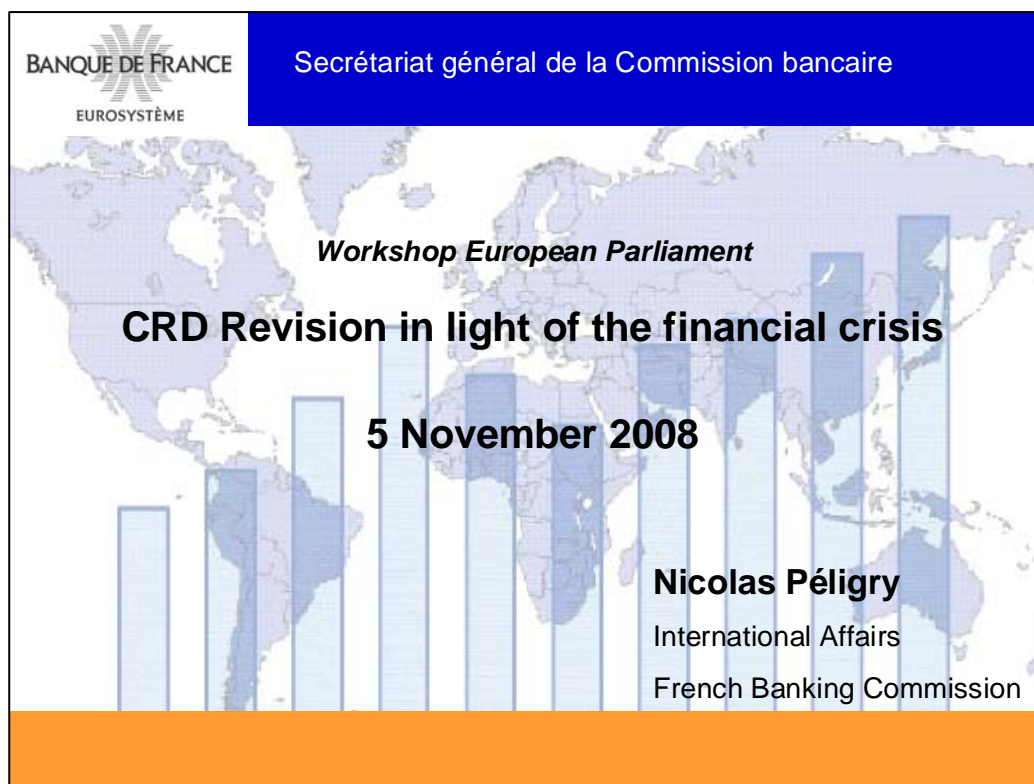


## **Session II - EU supervision-What is the right approach?**

Presentation by

**Nicolas Péligr**

**Deputy Head International Affairs Division, Banque de France, France**



**BANQUE DE FRANCE**  
EUROSYSTEME

Secrétariat général de la Commission bancaire

*Workshop European Parliament*

**CRD Revision in light of the financial crisis**

**5 November 2008**

**Nicolas Péligr**  
International Affairs  
French Banking Commission

## Outline

- 1) Are the CRD changes the right approach for banking?**
- 2) What should be the future of Level 3 Committees?**
- 3) How should the supervision be designed with regard to financial stability and crisis management?**

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SGCB

Nicolas Péligr  
French Banking Commission  
Workshop at the European Parliament, 5 November 2008  
CRD revision in light of the financial crisis

## 1) Are the CRD changes the right approach for banking?

### ➔ An enhancement of the regulatory framework on a number of key areas

- a) Tier one capital :
  - The current lack of precision is prejudicial to the level playing field and to financial soundness
  - Clear eligibility criteria should lead to upgrade the quality of the numerator of the solvency ratio
  - The sooner, the better
- b) Securitization
  - Incentives of investors and originators have to be rebalanced
  - Importance of qualitative, more than purely quantitative criteria, such as sound management of risk, whoever bears it

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## 1) Are the CRD changes the right approach for banking?

- d) Liquidity risk management
  - Enhanced requirements, designed to promote best practices (“Pillar 2” type approach)
  - For larger banks, key importance of developing robust internal methodologies
  - Framework under which supervisors, at national level, will carry out in-depth assessment of the liquidity profile of each bank, both from a quantitative and a qualitative perspective
- c) Large exposures
  - Current rules have to be simplified and designed to address the issues raised by excessive concentration on a single counterparty
  - The proposal is on the right track but its effects on inter-bank markets need to be carefully assessed

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SGCB

Nicolas Péligny  
French Banking Commission  
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CRD revision in light of the financial crisis

## 1) Are the CRD changes the right approach for banking?

### ➔ an up-grading of supervisory arrangements for the supervision of cross-border groups

- In a number of key areas : the principle of article 129-2 proved to be a success for the validation of internal models, it should be extent to other topics: pillar 2 and reporting
- A leading role for the home supervisor with strong involvement of host, including host of significant branches
- The home should be granted with the "last say" for strategic decision at group level, but this prerogative should be used in exceptional circumstances, after mediation by CEBS

5

SGCB

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## 1) Are the CRD changes the right approach for banking?

### ➔ the comparison with Solvency II for insurance companies

#### Three key differences:

- a) The group support
  - b) Coupled with the former point, the taking into account of full diversification benefits, at group level
  - c) The wider used of full-fair value, including for equities
- Would a convergence between insurance and banking sector, on such basis, be appropriate?
  - To which extent these regulatory differences reflect the differences of "business model" ?

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## 2) What should be the future of Level 3 Committees?

### → A central role to play in promoting convergence of practices

- a) Between Member States: the same EU rules should apply equally to all banking actors wherever they are located, taking into account the proportionality.
  - Need for the development of a real “European supervisory culture” : learning to work together
  - The Level 3 should be granted with adequate resources
- b) Between colleges of supervisors (“horizontal convergence”):
  - while colleges should be conducive for enhanced consistency of approaches between concerned home and host supervisors, there is a critical need to ensure a consistency between colleges
  - However, each of them should be left a certain leeway to adapt to the specificities of each group

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## 2) What should be the future of Level 3 Committees?

### → Should the current architecture be adapted?

- a) There is a clear need to speed-up the evolution currently ongoing so as to make the supervision of cross-border group more efficient and in line with the increase integration of financial activities in the European landscape
- b) However, the principle of a decentralized organization should not be challenged in itself
- c) The ECOFIN Council Roadmap and beyond

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### 3) How should the supervision be designed with regard to financial stability and crisis management?

- **An increased role of CEBS in the assessment of risk, in particular in the context of colleges of supervisors (in a “bottom-up” approach)**
  - a) The CEBS is the best placed to monitor micro-prudential risks
  - b) Bottom-up approach : the information collected and analyzed in the framework of the supervision of banking group provide a precious material to carry out risk assessment
  - c) A common data-base?
- **Strong coordination with ECB, through the BSC**
  - a) The complementarity between micro and macro analysis
  - b) How should CEBS and BSC should interact
- **The advantages in having banking supervision close to central bank.**

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Workshop at the European Parliament, 5 November 2008  
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**Presentation by  
Thomas Huertas  
Banking Sector Director, FSA**

***EU Supervision – What is the right approach?***

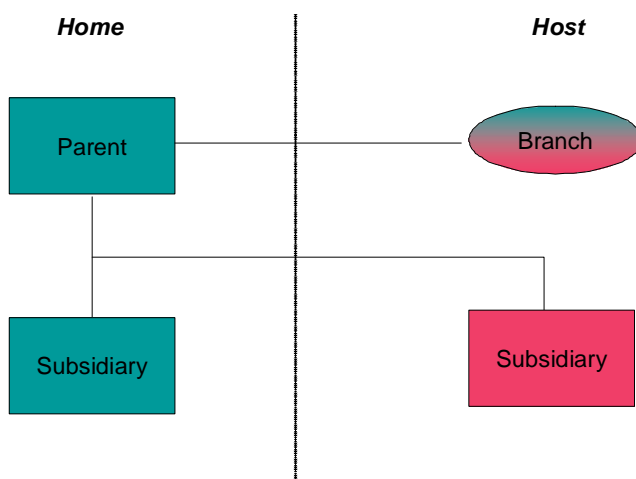
**Presentation before the  
European Parliament Workshop:  
CRD revision in the light of the financial crisis**

**Brussels**

**5 November 2008**

**Dr. Thomas F. Huertas  
Chair, Expert Group on Prudential Requirements, CEBS  
and  
Director, Banking Sector, Financial Services Authority (UK)**

**The structure of multinational groups**



## The framework for supervision in the EU

<b>Regulation</b>	<b>Liquidity</b>	<b>Resolution</b>
Single market  Freedom of establishment  Primacy of home country supervision	ESCB, but not a single central bank or a single currency  Lender of last resort: National responsibility subject to ECB and COM review	Solvency assistance is national matter subject to EU review (state aid)  Fiscal authority is national  Compensation schemes are national

**Supervision has to operate within the above framework but also recognise that EU firms operate globally and that global firms operate in the EU.**

## Progress toward common supervision

- Colleges of supervisors implemented and making a difference
- 3L3 committees
- Promotion of convergence
  - Guidance for supervisors in implementing directives
  - Training
  - Forum for dialogue to assure common response to problems/crises
- Advice with respect to new legislative/regulatory proposals
  - Responses to CfA from Commission
    - Hybrid capital
    - Large exposures
    - Liquidity
  - Own initiative advice

## Two approaches

	<b>Insurance (Solvency 2)</b>	<b>Banking (CRD and other directives)</b>
Group responsibility/ Group support	Home country exercises group supervision and assures solvency of subsidiaries	Home country approves models for capital adequacy but does not assure solvency of subsidiaries
Compensation scheme	No directive in place	Home country responsibility for parent bank but possibility of top-up into host country scheme of branch. Host has liability but limited influence. Subs are treated as if they were a parent bank in host country.
Liquidity	Not considered	Host country responsibility. CEBS work on good practices.
Solvency assistance/ resolution	Home country responsibility, including ultimately responsibility for subs of parent	Home country responsibility for parent, but not necessarily for subsidiaries.

## CRD amendments

- ✓ Include reference to EU obligations in national mandates for supervision
- ✓ Colleges to include significant/systemically relevant branches
- ✓ CEBS to provide operational guidelines and evaluate overall progress of colleges
- ✗ Securitisation “skin in the game” requirement

**Presentation by  
Andreas Ittner  
Member of the Governing Board, ONB, Austria**

## **EU supervision – what is the right approach?**

Workshop: CRD Revision in the light of the financial crisis  
European Parliament, Brussels, 5 November 2008

**Andreas Ittner**  
Member of the Board, Oesterreichische Nationalbank  
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### **The „incompatible triangle“**

