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4th ECFR Symposium

International Co-operation of Financial Supervisory Authorities

Thomas Schmitz-Lippert*
Executive Director
International Policy / Affairs
(Banking, Insurance and Market Supervision)

*the views expressed are those of the author and do not necessarily reflect the views of the BaFin

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1. Lessons learned regarding supervisory architecture

The financial crisis revealed need for revisions in the global and European supervisory architecture (**„formal“**=who supervises and how do supervisors co-operate)

- Enhanced cooperation and information exchange among supervisory authorities; strengthening supervisory colleges and crisis management
- A better link between macro-prudential oversight and micro-prudential supervision
- A global roll-out of supervisory colleges for systemically important internationally active banks
- Robust crisis management arrangements and effective resolution tools need to be developed (global level)

1. Lessons learned regarding the regulatory framework

- Revisions of the prudential rules/requirements (**„material“** =what is supervised)
- Gaping holes in the pre-crisis regulation
- Supervision only as good as regulatory framework supervisors operate in (was in shambles after 15 years of deregulation)
- Ensure **consistent and effective underwriting standards** for **mortgage products** (rules, enforcement, oversight)
- **Retention rules** (no complete risk transfer) to rein in originate-to-distribute model
- Consolidation rules of **off-balance sheet vehicles**
- Regulation / supervision of **credit rating agencies**
- Strengthening framework for **OTC derivatives** settlement (establishment of **CCPs)**

1. Lessons learned regarding the regulatory framework

- **Liquidity**: Basel liquidity coverage ratio (stress tested, short term), structured liquidity ratio (longer term)
- Mitigating **pro-cyclicality** in the system, including bank capital, provisioning, valuation and leverage
- Quality and quantity of **overall capital** in the system
- Addressing **accounting rules** (more convergence)
- Capturing **unregulated entities and products**
- (Internal) **risk management** needs to be enhanced
- Revision of **remuneration and compensation** schemes

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2. Revised global supervisory architecture and regulatory framework

„Washington Summit“ 15 November 2008

- Key message to the world and the industry

- no unregulated entities
- no unregulated products and markets
- no unregulated locations

- Immediate actions (until 31 March 2009) to mitigate pro-cyclicality, including the review of valuation and leverage, bank capital, executive compensation, and provisioning practices
- G20 – as opposed to G7/8 – setting the policy response to the crisis

2. Revised global supervisory architecture and regulatory framework

„London Summit“ 2 April 2009

Financial Stability Forum will be expanded and re-established with a stronger institutional basis and enhanced capacity as the **Financial Stability Board** (FSB). The **revised mandate** has a focus on

- **Assessment of vulnerabilities** affecting the financial system, the identification and oversight of **actions**
- Promotion of **coordination and information exchange** among authorities responsible for financial stability
- Guidelines and support in the establishment and functioning of **supervisory colleges**
- Support of contingency planning for **cross-border crisis management**
- Enhanced **collaboration with the IMF** (early warning and macro/micro linkages)

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2. FSB Structure and Working Groups

Financial Stability Board

Supervisory Authorities, Central Banks and Ministries of Finance of the G-20 countries and other institutions/organisations (e.g. EU COM, ECB, IMF, BIS, OECD)

Steering Committee

Standing Committee
Vulnerabilities Assessment
(SC AV)

Standing Committee
Supervisory and Regulatory
Co-operation (SC SRC)

Standing Committee
Standards Implementation
(SC SI)

Cross-Border Crisis Management Working Group

Standing Committee on Standards Implementation
- Expert Group -

+ coordination with the Standard Setting Bodies (SSBs)
most notably BCBS, IOSCO, IAIS and IASB

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2. Work in Progress / top priorities

- Addressing Procyclicality in the Financial System (FSB)
- Quality and Quantity of Capital (BCBS)
- Sound Compensation Practices (FSB)
- Cross-border Cooperation on Crisis Management (FSB)
- Central Counterparties (IOSCO)

2. Further steps

„Pittsburgh Summit“ 24-25 September

- Reforming compensation and remuneration practices
- Improving over-the-counter (OTC) derivatives markets (clearing through Central Counterparites by 2012 the latest)
- Improving the regulatory oversight of energy markets to address excessive price volatility
- Unregulated entities and produts
- Accounting (FASB/IASB)
- New Basel capital rules including impact assessment
- Implementation dates (staggered implementation)
- Addressing problems associated with systemically relevant banks (too big- / interconnected to fail)

2. Further steps

„Pittsburgh Summit“ 24-25 September (contd.)

• Cross-border resolution regimes (difficult; absence of cross-border burden sharing arrangements and deposit insurance schemes)

• Exit strategies (central banks liquidity, government guarantees and capital injections)

• Fiscal deficits vs economic stimuli

• Commitment to further fight non-cooperative jurisdictions (tax havens, money laundering, corruption, terrorist financing etc.)

3.1 Overview of new European Supervisory Architecture

• Report by the „**de Larosiere Group**“ of 25 February 2009

- prosposals to strengthen European supervisory arrangements with the objective to establish a more efficient, integrated and sustainable system

• **Commission Communication** on "European financial supervision" of 27 May 2009

- proposal for enhanced European financial supervisory framework, composed of two new pillars, i.e. European Systemic Risk Council (ESRC) and European System of Financial Superivsors (ESFS)

• **ECOFIN Conclusions** on strengthening EU financial supervision of 9 June, based on the Commission Communication

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3.1 Overview of new European Supervisory Architecture

- **Final Commission proposals** published on **23 September**

„legislative package“ includes 5 regulations on

- Establishing a **Europan Banking Authority** (EBA)

- Establishing a **European Insurance and Occupational Pensions Authority** (EIOPA)

- Establishing a **European Securities and Markets Authority** (ESMA)

- Establishing a **European Systemic Risk Board** (ESRB)

- **Accompanying document** outlining the possible changes that need to be made in the relevant sectoral legislation (technical standards, direct supervision, settling disagreements, general amendmends)

3.1 Overview of new European Supervisory Architecture

Further Proceedings (as envisaged by COM)

- 23 September 2009: Adoption of the Proposals by the Commissioners
- 28 September 2009: Start of negotiations at Council Working Groups (2 Working Groups: ESFS and ESRB)
- Adoption by Council and Parliament via co-decision procedure during Swedish presidency by end 2009
- Entry into force on 1 January 2011

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3.2 European System of Financial Supervision

Objective: strengthening of supervision and
cross-border cooperation

European System of Financial Supervision (ESFS)

Joint Committee of the European Supervisory Authorities

Sub-Committee on Financial Conglomerates (further SCs might be established)

European Banking Authority (EBA)	European Insurance and Occupational Pensions Authority (EIOPA)	European Securities and Markets Authority (ESMA)
National Banking Supervisors	National Insurance Supervisors	Nationale Securities and Markets Supervisors

3.2 Details and issues regarding the ESAs

• Striking right balance between ESAs and national supervisors, buy-in of authorities needs to be assured

• In general, the propsals provide the right balance but some major flaws remain:

1) Internal functioning of the ESAs

- Member State vs centrally driven authorities

- Independence from Commission

2) Interaction with national authorities and institutions

- **COMs** decision making powers addressed to **national authorities** regarding the application of **Community law** (on basis of recommendation by ESAs)

- **ESAs** decision making powers addressed to **national authorities** in case of **emergency situations** or to settle **disagreements**

3.2 Details and issues regarding the ESAs

- **ESAs** decision making powers (where competent authorities do not comply) addressed to **financial institutions** in case of **emergency situations** or to settle **disagreements** or regarding the application of **Community law**

3) binding technical standards can be **modified / added to** by **COM** (COM may endorse „at all", „in parts or with amendments", „not at all")

- Amendmends should be up to L2 only (COM should not be able to change standards)

4) QMV Nice Treaty (or if adopted – Lisbon Treaty)

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3.2 Details and issues regarding the ESAs

Why problematic:

• Delicate shift of responsibilities without transfer of accountability to EU-level as long as

- lender of last resort
- deposit protection
- burden sharing and
- insolvency laws

remain in national remits

• Legal and fiscal situation reflected in carve-out: ESAs‘ decisions are not allowed to impinge on Member States‘ fiscal responsibilities

• Enforcement of binding decisions of ESAs in absence of EU administrative law

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3.2 European Systemic Risk Board (ESRB)

Chair and Vice-Chair of GB

instructs on behalf of the GB

Secretariat
provided by ECB

Steering Committee (SC)
- Chair of GB (presides the SC)
- Vice-Chair of GB
- Chairs of ESAs
- EFC President
- Member of COM
- Five members of the GB which are also members of the General Council of the ECB

assists in decision-making process

analytical, statistical, administrative and logistical support

supports work

General Board (GB)

Voting members
- NCB Governors
- ECB President + Vice
- a member of EU COM
- Chairpersons of ESAs

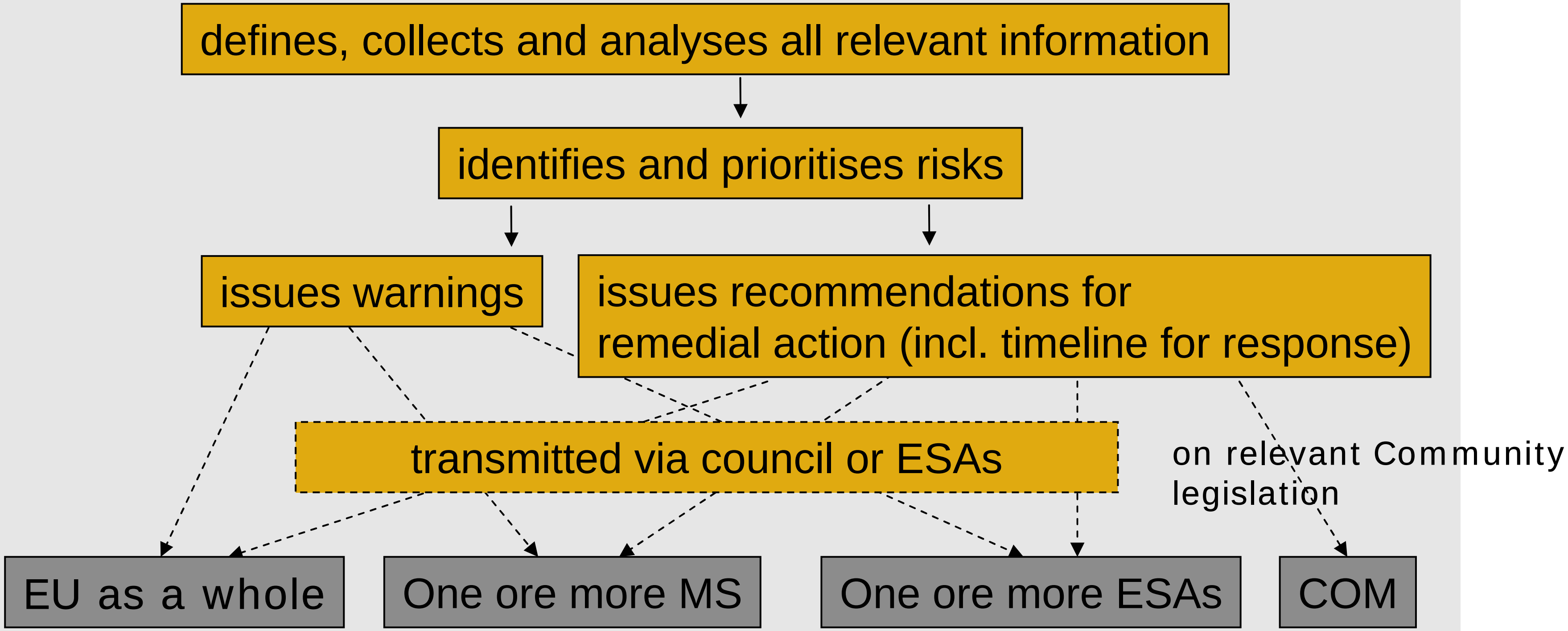
Non-voting members
- one high level representative per MS competent national supervisory authorities (may rotate)
- EFC President

Advisory Technical Committee (ATC)

assistance and advice upon request by chair of GB

3.2 Tasks of the ESRB

Objective: responsibility for macro-prudential oversight of financial system
to prevent and mitigate systemic risk



warnings and recommendations are not legally binding
but „act or explain“ procedure

3.3 Adopted and proposed changes to the regulatory framework

- CRD review (II, III, IV, V) picking up on and mirroring global initiatives

Initiatives include work on mitigating pro-cyclicality, introduction of capital buffers and supplementary measures (non-risk based leverage-ratio), retention of securitisations, provisioning, compensation and remuneration

- Solvency II

Framework Directive adopted by Parliament in April and acknowledged by ECOFIN in May (after intensive negotiations between Commission, Parliament and Council); June: Level 2 implementing measures and impact studies

3.3 Adopted and proposed changes to the regulatory framework

- Central Counterparties (CCPs)

Since October 2008, COM has worked with industry to reduce the risks in the CDS market by moving the clearing of contracts onto a European CCP (committment by banks to clear European-referenced CDS on one or more European CCPs)

- Credit Rating Agencies (CRAs)

Regulation adopted by Council and Parliament in April; puts in place a common regulatory regime for the issuance of credit ratings (CRAs need to apply for registration)

4.1 Supervisory colleges

- Forum for enhanced cooperation and information exchange among supervisors on individual undertakings
- Applicable to large internationally active credit institutions and insurance companies
- Stipulated at global (FSB) and European level (CRD)
- Need to be implemented by the End of 2009 for the largest, internationally active groups (globally as well as at European level)
- Scope covers „going concern“ and „emergency situations“
- Need to be intergrated into the wider financiial stability cooperation arrangements (including non-supervisory CBs, MoFs, DGSs)

4.1 „Variable geometry“ approach to supervisory colleges

- Resources of the home supervisors need to be balanced with the understandable need of host supervisors for information

- Need to produce meaningful results, given the varying confidentiality arrangements in place (bilateral and multilateral MoUs)

1) Core / general college

2) Global / regional, esp. EU (e.g. Art. 131a CRD)

3) Kind of institutions: crisis management (central banks for ELA, resolution authorities where appropriate, MoFs (home/host?))

4) Cross-sectoral for conglomerates

5) Industry: institutions (banks, insurance companies)

6) Most challenging: Hierachical level (institution and authorities), depending on the subject

4.1 Supervisory colleges according to the CRD

- Article 131a CRD requires the consolidating supervisor to set up colleges of supervisors for credit institutions, based on written arrangements
- Tasks according to Article 129 CRD include the planning and coordination of supervisory activities in going-concern and emergency situations, the preparation of joint assessments, the implementation of contingency plans and communication to the public
- More details provided by CEBS in the „Template for written arrangements" (e.g. on sharing and delegation of tasks, on-site examinations, internal model validation, joint decisions regarding pillar I, planning and coordination in going concern and in emergency situations) and the Good Practices Paper

4.2 Crisis management arrangements and cooperation

2008 EU MoU on Cross-Border Financial Stability

• Provides for cooperation arrangements among supervisory authorities, central banks and ministries of finance in crisis situations („Cross-Border Stability Groups“)

FSF Principles for Cross-border Cooperation on Crisis Management

• Principles distinguish between „preparation for“ and „managing“ a crisis

• Regular meetings (alongside core colleges) to consider specific issues and barriers to coordinated action that may arise in handling a crisis

• Contingency plans to be developed by firms and to be reviewed by authorities

4.2 Crisis management arrangements and cooperation

Large and complex institutions have proved to bear particular risks that need to be addressed („too big to fail“, „too connected to fail“)

BCBS Cross-Border Resolution Group

- Discussion of barriers for cross-border resolution (differences in resolution regimes), development of winding-down plans and convergence of deposit guarantee schemes

BCBS Macroprudential Supervision Working Group

- Evaluation of capital surcharges for systemically important banks and/or other supervisory tools to mitigate / counterbalance systemic risks and moral hazard (e.g. stress testing)