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Supervisory Arrangements: Work in Progress

In the wake of the adoption of the Capital Requirements Directive (CRD), EU regulators and supervisors are devoting many efforts to ensuring correct implementation of the new rules, backed up by the convergence of practices being pursued by level 3 committees. While these issues remain the priority for the time being, the EBC is conscious that the changing market structures resulting from increasing integration of the EU financial service markets pose new challenges for the organization of supervision within the EU.

The EBC has been proactive in this area and has identified five key areas of supervision where it believes progress is needed in the wake of the adoption of the CRD: Liquidity risk management, emergency liquidity assistance, crisis management, deposit guarantee schemes and re-organisation and winding up procedures. Work on the five interlinked areas contributing to the debate on supervisory arrangements is progressing.

On crisis management, the Economic and Financial Committee has set up an Ad Hoc Working Group (AHWG) to focus on appropriate supervisory arrangements for crisis management. This group first met on the 15th November 2006 and has met on two subsequent occasions. The EFC AHWG is due to issue an interim report on "Developing EU Financial Stability Arrangements" to the EFC Financial Stability Table on 4th April and a final report in September 2007. In addition to this work, the Banking Supervision Committee (BSC) and the Committee of European Banking Supervisors (CEBS) have recently jointly developed recommendations designed to assist EU banking supervisors and central banks in managing and preparing for cross-border systemic crises.

On emergency liquidity assistance, the Banking Supervision Committee is on track to deliver its report "The EU Arrangements for the Provision of Emergency Liquidity Assistance" to the EBC for discussion at its July 2007 meeting.

Updates on the work that has been carried out on liquidity risk management, deposit guarantee schemes and winding-up and re-organisation of credit institutions are the subject of more detailed articles below.

The Financial Services Committee has set up a subgroup on long term supervisory arrangements. This group will identify the weaknesses and strengths of the current supervisory system for banking groups,

Work on liquidity risk management is not just about convergence within the CRD...

..It is also a key component of the broader work on supervisory arrangements...

insurance groups and financial conglomerates and examine the scope for further practical improvements in the operation of the current system. The subgroup is due to provide a report to the Financial Services Committee by October 2007.

DG Internal Market and Services is organising a high level conference to be held on 26 June on challenges for EU supervisory arrangements in an increasingly global financial environment. The conference will cover supervisory arrangements in three sectors, banking, insurance and securities. This conference will be an opportunity to take early stock of progress and developments in anticipation of the Commission's report to the European Parliament and Council by the end of 2011.

Liquidity Risk Management: Commission issues a call for advice to CEBS

On March 6th, the Commission Services issued call for technical advice no. 8 to CEBS on liquidity risk managementⁱ, which will be based on two major pieces of work:

- a. Update of the survey carried out in 2000 by the Groupe de Contacte on national regulatory framework practices, with the inclusion of the twelve new Member States and giving due consideration to any different treatment given to specific type of credit institutions. The deadline is July 2007.
- b. Deepening of the analysis on this topic by looking at issues such as collateral, liquidity market risk, the impact of payment and settlements system design on liquidity risk management and the use of internal methodologies by sophisticated firms. The deadline is January 2008.

The interest of the Commission services is not solely restricted to ensuring convergence within the context of the Capital Requirements Directive, but it is also part of the broader debate on future supervisory arrangements in the EU, which, includes ongoing work on crisis management and the related issues of cross-border movement of assets and the review of the directive on winding-up and reorganisation of credit institutions.

The call for advice is consistent with the better regulation agenda in that it represents a "bottom-up" approach, i.e., without any prior commitment to the final outcome. CEBS will seek to clarify the above technical issues and identify possible policy issues and ensure as much as possible parallelism with the Basel Committee work on this issue due to similarity in the approach taken so far.

Re-organisation and winding up of credit institutions: Commission plans public consultation

In November 2006, the EBC gave its approval to the preparation of a public consultation on the reorganisation and winding up of credit

The EBC is keen to understand where there are any ambiguities, gaps and conflicts in the current framework...

...this work is also an important part of the broader work on supervisory arrangements

The EBC believes that before any fundamental overhaul of the present schemes is considered it is first necessary to clarify the broader issues...

In the meantime, further work on pragmatic issues is undertaken by pursuing non-regulatory solutions...

institutions (2001/24/EC) Directive.

A draft questionnaire has been submitted to the EBC for approval at its meeting on 27th March, further to which the consultation is expected to be launched at the end of April. The draft questionnaire has been drawn up in two parts:

- The first part will seek to find out whether the present directive on the reorganisation and winding up of credit institutions functions properly or whether there are provisions that may need improvement. The questionnaire is based on initial findings from an earlier questionnaire which was sent to the EBC in September 2006. The opinion of stakeholders will be sought on these issues and whether there are any further ambiguities, gaps, and conflicts in the Directive. In particular, the questionnaire will be looking at whether anything in the present directive contradicts the current framework of supervisory responsibilities and arrangements.
- The second part of the consultation will examine the treatment of financial groups in a crisis situation, in order to discover what factors might prevent an optimal crisis management or reorganisation in groups that operate cross-border. It will be important to detect whether the reorganisation provisions are as useful as they could be in facilitating the crisis management process at an early stage, and how the current arrangements may sit with cross-border and increasingly global financial groups with subsidiaries in different Member States.

Deposit Guarantee Schemes: Work begins to improve practical functioning

The Commission's review of the Deposit Guarantee Schemes Directive (94/19/EC) is now at an advanced stage. As outlined in the previous newsletter, the Commission has issued a Communication, in which it describes the main policy lines to take. The EBC had endorsed the Commission's proposed approach to deal with pragmatic issues at a first stage, while further assessing the feasibility of progressive issues in the longer term, once broader issues surrounding supervisory and burden sharing arrangements have been further clarified.

Until this clarification will be obtained, the Commission will, however, not remain idle. In its Communication, the Commission has identified six issues where further progress can be achieved by a self-regulatory approach. After the Working Group on Deposit Guarantee Schemes' endorsement, further work on these issues has now been kicked off. Member States, Deposit Guarantee Schemes associated in the European Forum of Deposit insurers (EFDI), the Commission, and in particular its Joint Research Centre, will be working towards possible solutions for the following issues:

- In order to ensure a seamless coverage of depositors' liquidity, the range of products and liquidity covered under national Deposit Guarantee Schemes will be examined.
- To improve the practical functioning of topping up arrangements,

Complexity poses challenges for the group to reach consensus..

..But good progress is being achieved...

where a branch tops up its coverage of the home scheme by an additional coverage of the host scheme, existing arrangements and encountered problems will be analysed. On this basis, it is intended to develop a non-binding model arrangement that may help to improve the functioning of topping up arrangements in a crisis.

- The needs of Deposit Guarantee Schemes in the context of possible improvements on the exchange of information will be assessed.
- With regard to a fair and appropriate calculation of banks' contributions to Deposit Guarantee Schemes, common voluntary approaches on risk-based contributions to DGS will be developed and be subject to a quantitative analysis.
- In order to raise awareness of depositors and to improve their information on Deposit Guarantee Schemes, best practices in this field will be identified.
- Based on a stocktaking of the current situation and past events, the duration of payment delays to depositors will be analysed.

The timeframe for these activities has been set between 1.5 and 3 years in order to feed into the 2011 Commission report on crisis management.

The final report of the Joint Research Centre on the cost impact of a possible harmonisation of funding mechanisms, which has largely fed into the Communication, can now be downloaded from DG MARKT's web site

http://ec.europa.eu/internal_market/bank/guarantee/index_en.htm.

Capital Requirements Directive: Progress in the transposition group

As of March 22, the CRD Transposition Group has received 228 questions, about 60% of which come from supervisory authorities and finance ministries and the remainder from firms, trade associations and other correspondents. So far, 191 answers have been published on the CRDTG [website](#)ⁱⁱ.

In many cases, it has proved difficult to meet the intended timeline for publishing answers to the questions (66% of published answers within the 3 months target), as the complexity has often resulted in difficulties to provide draft answers and reach agreements in the working group quickly. Nonetheless, the Commission services remain optimistic that there are no questions where it will not be possible to reach consensus on an answer. A meeting was held in March where good progress was achieved on all of these issues, including a common understanding of how to deal with recognition of national discretions and options of the CRD.

Possible modifications of the CRD, based on clarification brought by the CRDTG, may be discussed at the CRDTG meeting at the end of the year.

CEBS has been asked to pursue the its work to try to achieve substantial convergence in the prudential treatment of hybrids...

...and to report back by December 2007...

Own Funds: CEBS requested to report on convergence of supervisory treatment of hybrid capital instruments

The technical advice on own funds which CEBS submitted in June 2006 has highlighted the different supervisory treatments as concerns both quantitative limits and qualitative requirements in relation to hybrid capital instruments. This raises level-playing field issues for credit institutions and opportunities for regulatory arbitrage; it has an impact on the structure and quality of own funds and it may create significant competitive (dis)advantages in the market, not just between Member States but also cross-sectorally between credit institutions and insurance entities.

Further specifications to the Commission's original call for adviceⁱⁱⁱ were sent to CEBS at the beginning of August and in October 2006 asking CEBS for:

- a) a detailed taxonomy (absent of data) of own funds constituents and deductions to be submitted by end November 2006.
- b) a quantitative survey on hybrid instruments, together with any qualitative commentary from CEBS, to be delivered by 28th February 2007.
- c) the taxonomy completed with national data from 31st December 2006, to be submitted by May 31st 2007.

CEBS has now delivered the first two pieces of work, and in so doing they have confirmed the high quality of their contributions and that issue of hybrids is a material one within the EU.

The Commission services believe therefore that it is essential and urgent to pursue substantial convergence in the treatment of hybrids, within the present international definition of regulatory capital. In particular, the Commission services consider that it would be appropriate for CEBS to further discuss the main qualitative features of hybrids (permanence, loss absorbency and flexibility in payments) in order to identify any areas in respect of which national supervisors would be willing to achieve a common view.

CEBS is due to report back to the EBC on the progress it has achieved in relation to convergence by December 2007. Based on the above technical analysis and consistent with the better regulation agenda, the Commission services could then consider how further convergence could most appropriately be achieved in this area.

However, care will need to be taken that EU work on convergence in this area will not prejudice any subsequent proposals made on hybrids in the context of the planned longer term review of own funds by the Basel Committee on Banking Supervision.

CEBS is expected to deliver advice in two stages – September 2007 and February 2008...

CEBS has found that treatment of commodities differs substantially in accordance with the relevant importance of commodities business in the countries surveyed...

Large exposures: Plans for a wide-ranging review of the Directive

In recognition of the very limited changes made to the large exposures (LE) regime in the CRD, and in order to address any other technical changes, Article 119 of Directive 2006/48/EC and Article 28(3) of Directive 2006/49/EC require a review of the existing LE rules "together with any appropriate proposals" to be submitted to the European Parliament and to the Council by 31 December 2007. Work on the review commenced in 2005, and a call for technical advice was issued to CEBS in December 2005. CEBS submitted this technical advice on supervisory practices; industry practices and the use of credit risk mitigation in April and August 2006.

Following the meeting of the EBC Working Group on Large Exposures (WGLE) in September 2006, the EBC agreed to extend the original timeline of the review beyond December 2007. This extension of the timeline will facilitate a more wide-ranging review. A further call for technical advice was sent to CEBS in early January 2007^{iv} which is due for delivery in September 2007 and February 2008.

In January 2007, the European Commission launched an 'Action programme for reducing administrative burdens in the EU.'^v This programme will measure administrative burdens related to certain pieces of Community legislation and national transposition, and will consider appropriate reduction proposals to address these administrative burdens. The existing LE regime has been identified as a priority area within this programme, and as such an exercise will be undertaken in which the administrative burden of the current rules will be measured.

The next meeting of the WGLE is anticipated for October 2007, when the WGLE will have an opportunity to discuss the CEBS technical advice that will be submitted in September 2007.

Commodities: CEBS delivers first set of advice

The EBC has been considering the treatment of commodities, and in August 2007 the Commission issued a call for technical advice to CEBS.

In January, CEBS delivered the first instalment of advice comprising a survey of prudential regulation of commodities derivatives business in the EU and in selected third countries (see <http://www.cebs.org/press/04012007.htm>). The survey shows that the current prudential regimes for commodities business vary among the countries that responded. Given that relevance of the commodities sectors differs for each country, only few countries have implemented specific rules so far. However, most apply regulations to commodities firms that resemble the requirements of the Capital Adequacy Directive and which address at least firm-related and product/transaction-related risks.

CEBS has identified no specific level playing field concerns...

The Directive will maintain a tight approval procedure and closed list of assessment criteria...

A Green Paper is planned for late Spring...

...setting out the Commission's overarching objectives of its policy...

A second part of the advice which should fundamentally analyse the prudential risks arising from commodities business is due by September 2007.

3rd country branches: CEBS looks into level playing field concerns

Following discussions at the EBC meeting last November, the Commission services asked CEBS to examine whether the operation of branches of credit institutions from third countries that are exempted from EU solvency supervision might be a cause for concern when the respective third countries had not yet adopted Basel II. In its response which will be discussed at the March 2007 EBC meeting, CEBS reported back that it had not identified specific issues, although some CEBS members had expressed level playing field concerns about the potential impact of differences of timelines for the implementation of Basel II.

Revision of Article 16 / 19 of the Banking Directive: Compromise agreed

Negotiations between the Commission, Parliament and the Council have been concluded successfully on the Commission's proposal tightening the procedures that Member States' supervisory authorities have to follow when assessing proposed mergers and acquisitions (M&A) in the banking, insurance and securities sectors. The European Parliament has voted on the tripartite compromise; this compromise also has political agreement at the Council and will be adopted at ECOFIN on the 27th of March.

The compromise maintains a tight procedure and a closed list of assessment criteria. In response to the concerns expressed on the duration, more time has been allowed (sixty days as compared to the original proposal of thirty days) for the assessment to be carried out.

Retail Financial Services: Green paper planned for the spring

Retail financial services are an essential part of the everyday lives of EU citizens. Despite significant progress in delivering a Single Market for financial services in recent years, studies show that retail financial services integration has not yet reached its potential and that competition is insufficient in some areas, leaving EU consumers unable to take full advantage of the benefits of the Single Market.

The Commission will issue a Green Paper on Retail Financial Services in late Spring 2007. Following on from the Commission's White Paper on Financial Services 2005–2010^{vi}, the results of the Commission's sectoral inquiry into retail banking^{vii} and the interim report on business insurance^{viii}, the Green Paper will set out the overarching objectives of the Commission's policy in the area of retail financial services and present in more detail the actions necessary to bring the benefits of

The new Comitology rules have granted the European Parliament more extensive powers of control...

integrated EU financial market to users.

The Green Paper will bring together existing different initiatives in the field of retail financial services such as mortgage credit^{ix}, bank account mobility^x, financial education and highlight areas where more work may need to be undertaken, for example, insurance or saving for retirement. The Green Paper on Retail Financial Services does not replace the White Paper on Mortgage Credit which will be published at the end of June 2007.

After the publication of the Green Paper, a public consultation will be held in order to help prepare the Commission's final policy orientations.

News in Brief:

Comitology in the EBC: alignment of banking Directives with new rules


Under the Treaty the Council can confer to the Commission the power of adopting the measures necessary to implement Community legislative acts. The Commission carries out this task in co-operation with committees composed by Member States delegates (comitology procedures). The rules governing these procedures laid down in Council Decision 1999/468/EC have recently been amended (Council Decision 2006/512/EC) in order to grant the EP more extensive and substantial powers of control over the implementing measures the Commission may adopt.

As a consequence of the introduction of the new comitology rules, it is necessary to bring in line with the new rules, a number of existing basic acts, including three directives in the banking area (Directive 2006/48/EC relating to the taking up and pursuit of the business of credit institutions, Directive 2006/49/EC on the capital adequacy of investment firms and credit institutions and Directive 2002/87/EC on financial conglomerates). The process for adapting the existing comitology provisions in these directives to the new rules has started with the adoption by the Commission of legislative proposals on 22 December 2006 which will be discussed and adopted by the Council and EP. The whole process should be finalised by the end of April 2007.

Since its inception in 2005, the EBC has only twice made use of its comitology powers, most recently in order to modify the list of multilateral development banks benefiting from a 0% risk weighting according to Annex VI, Part I, point 20 of the Capital Requirements Directive (2006/48/EC).

Commission to launch survey on certain exempted credit institutions

At the EBC meeting on 27th March, EBC members agreed in principle to respond to a survey aimed at determining which Member States currently apply Article 3 of the Capital Requirements Directive (2006/48/EC) allowing Member States, under certain conditions, to exempt credit institutions which are organised in a network from certain requirements laid down by the Directive.



Article 3 was originally introduced by the First Banking Co-ordination Directive 77/780/EC and later reproduced without substantial changes in the recasts of Banking legislation. The Commission wishes to clarify if and how this derogation is currently applied by Member States, in particular to check whether the provision still serves its purpose or should be revised.

ⁱ http://ec.europa.eu/internal_market/bank/calls/index_en.htm

ⁱⁱ http://ec.europa.eu/internal_market/bank/regcapital/transposition_en.htm

ⁱⁱⁱ http://ec.europa.eu/internal_market/bank/docs/calls/2006call-for-advice_en.pdf

^{iv} http://ec.europa.eu/internal_market/bank/docs/calls/070105_call_for_tech_advice_en.pdf

^v http://eur-lex.europa.eu/LexUriServ/site/en/com/2007/com2007_0023en01.pdf

^{vi} COM (2005) 629, December 2005.

^{vii} "Report on the retail banking sector inquiry", SEC (2007) 106, January 2007.

^{viii} "Report on the Business Insurance Sector Inquiry", Interim Report, 24 January 2007.

^{ix} For further information see: http://ec.europa.eu/internal_market/finservices-retail/home-loans/integration_en.htm

^x For further information see: http://ec.europa.eu/internal_market/finservices-retail/baeg_en.htm