



Secretariat

CPL 2008 10

20 March 2008

Minutes of the eleventh meeting of the Consultative Panel

19 February, Stuttgart

1. Opening and introduction of the meeting

The eleventh meeting of the Consultative Panel was held in Stuttgart, Germany and hosted by Mr. Siegfried Jaschinski, Landesbank Baden-Württemberg (LBBW).

- The minutes of the October meeting (*CPL 2007 33*) has been published on the CEBS website <http://www.c-eps.org/CPL.pdf>
- The agenda of the meeting has been approved by the members and observers.

2. Credit and liquidity market turmoil

a. Draft "Lessons learnt from the tensions triggered by the sub-prime crisis"

The sub-prime crisis is a subject of utmost importance that receives a lot of attention of different forums, up to the highest political levels. A roadmap has been developed, which has been adopted by the ECOFIN. Effective communication on the "lessons learned" between the supervisory community and the industry is crucial. The Consultative Panel has established an ad hoc drafting team, which prepared initiatives and provided the industry's perspective on the "lessons learned" from the current market turmoil. The report has been presented by one of the Panel members and then the Chair of the Panel opened the discussions.

The paper on the 'Lessons learned from the Financial Markets crisis' discussed certain issues around the following areas:

- Improvement of bank internal governance, including minimum standards for supervisory board members
- Improvements of risk management practices, particularly
 - Extension of modelling and stress testing frameworks
 - Improvements in Liquidity Risk Management
 - Less reliance on external ratings
- Increased transparency and disclosure improvement at product level
- Changes of selective Accounting and Valuation Practices

- Intensifying the public-private dialogue at all levels; sharing market information and macro-prudential analysis with supervisors and central banks.

The outcomes of the discussions were that CEBS received valuable views from the Panel members on their assessments of the market turmoil situation. The focus of the discussions was mainly on some areas within Pillar 2. This should not lead to new rules, but rather to guidance which could be implemented rather fast. Panel members raised that on business risk and internal governance more work could be done.

The main lesson to be learned from the entities that collapsed is that they had business models that raised eyebrows in the industry.

Panel members had been informed that CEBS and its members do not have specific principles on business model risk, which might merit further attention since it is considered by the industry as a very important issue and is also mentioned in the CRD as an important factor in the P2 assessment.

A second very important issue to consider as a consequence of the current market turmoil was the knowledge and skill-set of the executives and non-executives. The Panel suggested/proposed that a number of principles should be laid down to address the educational issue. Apparently in a number of instances there was a lack of knowledge and experience needed to manage the bank in question. The panel noted that they are willing to further work on this subject (code of conduct on the qualification of certain key personnel).

The importance to understand the possible domino-effects was another important topic of the discussions. In order to achieve it, the Panel advised to further strengthen the cooperation between central banks and supervisors.

The work on liquidity risk has been considered to be important. Based on the Panels' feedback, the current initiatives of CEBS should be taken to the next level. Stress testing and the use of extreme stress test scenarios should be more emphasised. Stress testing on a macro level was also discussed, and the Panel asked CEBS representatives whether a link between the work done by CEBS and IMF, with a view to possibly harmonising stress testing reports should be there.

On the need for more transparency and more focus on Pillar 3, there were diverging views among Panel members. Some felt it to be very important, others felt that more transparency doesn't necessarily lead to more confidence in the markets. CEBS presented its way forward on its work on transparency, which didn't receive negative comments from the panel.

The current situation of the first test of Basel II, in relation to its possible pro-cyclicality effects, which could lead to a deterioration of tier 1 capital, has been brought up by Panel members. Therefore more emphasis should be given to contingency capital planning under Pillar 2.

Panel members raised their criticism towards rating agencies. Supervisors should not let the rating agencies take over the work of the supervisor. The Panel felt that supervisors rely too heavily upon the work undertaken by the agencies, without applying similar review/approval standards as for banks. Also Panel members noted that the growing role of non-supervised market players was progressively undermining the impact of supervisors and CEBS on financial markets.

The Consultative Panel members and CEBS representatives agreed on improving cooperation in addressing issues raised in the note on "lessons learned", preferably by means of the industry expert groups that are being set up in areas of liquidity, valuations and transparency.

The members and observers of the Consultative Panel members have been asked to send their written contributions and further comments on the draft "lessons learnt" paper in order to enrich the text. The analysis of the tensions triggered by the sub-prime crisis should go one step further (into another phase of development) and the next version should contain recommendations.

b) Concerns on possible credit crunch

One of the Panel members presented an introductory paper on the current state and future outlooks of the credit markets. Then the floor was opened to discussions.

The analytical paper addresses concerns regarding a possible credit crunch from the perspectives of financial markets and the real economy. Looking ahead, the increased risk aversion of banks, the adverse developments in some markets and possible negative effects on credit supply and on the real economy raised concerns and could generate further pressure on banks' financial conditions.

The paper draws the following conclusions: Economies are clearly decelerating, albeit growth is expected to remain in positive territory. But the outlook remains very uncertain – confidence is vulnerable to further unexpected events and risks remain skewed to the downside. It is too early to say whether capital shortages are constraining bank lending. Sovereign wealth funds have played an important part in recapitalising institutions, and the evidence to date suggests that tighter credit reflects a heightened focus on risk management – selectively impacting higher-risk borrowers - rather than a more widespread 'credit crunch'.

3. Update from the Commission on CRD

The representative of the Commission updated the Panel on the recent developments regarding the CRD; on the intentions of the Commission as to the amendments to the CRD. Some of the timelines have been given. Changes to the CRD, will have to be introduced by the latest, October 2008 to feed into the legislative process.

The main issues have been highlighted:

- Hybrids and Large Exposures
- Home/host issues
- Functioning of colleges
- Mediation mechanisms
- Framework for securitization
- Liquidity risk
- National discretions
- Pillar 2 / Reporting requirements.

On national discretions, the representative of the Commission, and Panel members urged CEBS to present their proposals in the near future. The reason for this, is the tight deadline that the possibility to present changes to the current EU Directives is to the European Parliament October 2008. The representative of the Commission also noted the key principles the Commission was following when issuing regulations: 1) clear and legally sensible drafting; 2) consultation with finance ministries, supervisors and the industry; 3) impact assessments.

4. Public consultation and informal dialogue

a) Planning of Panel's activities in 2008

CEBS finds it very important and useful to present as well as periodically update on its' calendar, and inform the Panel members well in advance on the planned dialogue based on the CEBS work program.

Based upon the CEBS work programme for 2008 a note has been prepared to identify areas in which and the timing of possible contributions from the Consultative Panel. In order to streamline the planning of contributions from the Consultative Panel, this note will periodically be provided to the Panel.

Panel members have proposed a couple of more topics to be discussed between supervisors and industry representatives (stress testing; more efficient regulation).

The Consultative Panel agreed with the planned interaction with CEBS and is fully available to provide the necessary input.

b) Industry expert groups and their working procedures

CEBS has established 5 groups for technical dialogue in the following areas: liquidity risk, national discretions, reporting, valuation and recognition of illiquid assets and pillar 3 (including transparency of securitisation and structured products).

CEBS appreciates the active support of the Panel for sending their nominations. CEBS prepared the "**Draft principles for the informal dialogue with industry expert groups**" which aimed to set out the main principles of communication between CEBS and the recently established expert groups for technical dialogue on order to contribute to a consistent, structured and streamlined approach in the technical dialogue. An important principle is that the industry expert group should consist of highly qualified technical experts from financial institutions and other interested parties and that the interaction with CEBS would take place in a manner that best suits the topic at hand.

Furthermore, the aim of a more regular industry participation is to have a well balanced and good quality CEBS-product, which should not be seen as replacing the consultation process.

Based on the request / proposal of the banking associations (the Panel Observers) they would like to be represented in all five industry expert groups even if it is only an observer status. Some Panel members also discussed the need to establish another additional industry expert group on economic capital models. As

the outcome of the discussions, for the time being CEBS will not establish such group, but await for the outcome of the work done by CEBS in 2008.

The Panel agreed on and approved the draft principles of the dialogue. The final version of the Principles will be distributed to the CEBS members and observers at their March meeting, to the Consultative Panel members and observers and the industry expert groups as well.

5. Update on work streams

Mrs. Kerstin af Jochnick, Chair of CEBS gave an update on three work streams:

a) Own funds

Panel members have been informed that CEBS published a consultation paper in December 2007 (CP17) which presents common proposals on the three key criteria for the eligibility of Tier 1 hybrids and on the grandfathering of issued instruments that do not comply with these requirements. Comments and responses to the consultation paper were to be sent by **22 February 2008**.

From the feedback CEBS has already received during the public hearings and in written form the industry concerns focus on a limited number of issues such as the explicit rules on loss absorbency and the limit for the inclusion of Tier 1 hybrids. CEBS will consider all comments in the finalization of the advice to the Commission.

The Panel raised the tax issue and asked CEBS that the proposal should be accommodating the different tax regimes in the EU. It was noted, that in the current market turmoil situation, it is important to use liberal grandfathering rules. It was also flagged that the way the limits work, is still confusing/unclear, therefore the Panel asked CEBS to insert/add extra examples, which would possibly help. The criteria should be principles-based without prescriptive rules on the national level, so instruments could be applied in more jurisdictions.

CEBS has also received comments on its consultation practices. The process is being reviewed and in the light of the comments, CEBS will respond to them in a formal letter.

b) Large Exposures

CEBS has been working on the review of the large exposures regime for some time and is finalizing its work with the second part of the advice to the Commission. A consultation paper – CP16 (on CEBS' Part 2 Advice on LE) – which was published in December 2007 and published for a public consultation until 22 February 2008. A public hearing was held in 15 January 2008 to gather views from markets participants at an early stage. CEBS will deliver its Part 2 advice to the Commission by 10 March (in the form of a draft Advice) to be considered at the EBC 14 March meeting. The final Advice will be published by end March.

Based on the discussions, The Panel considered that the rules for intra-group exposures were not found to be useful and the definition of connected clients leads to ambiguous implementations. Furthermore, the rules for the intra-bank exposures can have negative impacts on their current work and decision in some areas. It was stated that it would be harmful to include the limits in the future

regulation of large exposures. The Panel is very concerned about the level of playing field with US banks whose trading business is largely exempt from Large Exposure rules. Panel members expressed their level playing field concerns vis-à-vis US competitors, especially with reference to the derivatives business, and argued that new requirements would have to be addressed within the Basel framework and not in an isolated European directive.

c) IWCFE

The Panel has been informed of this year's proposed 2008 Interim Working Committee on Financial Conglomerates (IWCFE) work plan.

The work on equivalence, which has been done by the Third Country Supervision Working Group, has now been endorsed by the IWCFE, CEBS and CEIOPS, and is about to be sent to the European Commission (EC), in advance of the discussion by EU finance ministries at the European Financial Conglomerates Committee (EFCC) meeting, scheduled for 11th April 2008.

It was announced that the advice will shortly be posted on CEBS' and CEIOPS' website. The advice in respect of the Swiss authorities notes that both the FOPI and the SFBC were found to be equivalent notwithstanding some limited caveats which are set out in the advice. Similarly the advice in respect of the five US supervisory authorities (Fed, OCC, OTS, NYSBD and the SEC) was found to be equivalent notwithstanding limited caveats, as set out in the US advice.

Panel members have been informed that CEBS and CEIOPS published the IWCFE's Consultation Paper on the Advice on the differences in sectoral rules on eligible capital for the supervision of financial conglomerates on 29th January 2008. This advice forms the conclusion to the IWCFE's previous reports analysing the existence and impact of the sectoral differences published in January and August 2007. The consultation will run unto 7th March 2008, and a hearing of market participants was held at CEIOPS' office on 19th February.

6. Roadmap of Reporting (COREP and FINREP)

Arnoud Vossen, Deputy Secretary General of CEBS, provided an overview of CEBS projects on supervisory reporting for the coming years, in order to have one fully harmonized reporting system by 2011. The ECOFIN conclusions on the Lamfalussy review mandated CEBS to prepare a timeline for delivering an EU-wide reporting framework so as to have a single set of data requirements and reporting dates. CEBS will conduct a number of projects on the reporting frameworks:

- Standardisation of reporting dates: that is open for consultation until mid-April.
- Streamlining of FINREP
- User-test on COREP
- Analysis of simplified reporting procedures for cross-border groups: one-entry point.

CEBS has committed to work on these issues, within the boundaries that have been defined by the CRD and IAS/IFRS and on the other hand CEBS also need the industry to be as specific as possible in identifying the practical problems they face.

The Expert Group on Financial Information (EGFI) would like to engage with the industry in these exercises, through the industry experts' group recently created, in order to help to narrow the expectations gap with the industry. During the meeting the suggested timeline had been discussed.

Panel members argued that first of all Pillar 1 need to be fully harmonised, to enable the use of one set of definitions in reporting cross-border. To accomplish this, the project on national discretions needs to be a success.

CEBS agreed with the importance of harmonised definitions. But also put forward that some definitions cannot be changed by CEBS. The reporting project takes the current setting as defined by the CRD and IFRS as a given.

Some Panel members also argued that convergence in reporting would only work when there is convergence in off-site analysis, so supervisors also have to develop principles for a common approach to off-site supervision. Harmonisation in this area also means that banks reporting mechanisms need to be harmonised too, so this would then also lead to principles addressed towards the banking community.

The industry furthermore emphasized that only the actually used information should be asked by supervisors. The Panel remains unconvinced of the value of a new IT reporting system, if reporting is not harmonised and standardised within the European Union. CEBS will consider this in the user tests we do on COREP and FINREP. Some banks argued that the project comes too late since the IT-investments have now already been made. Other banks were still in favour of proceeding with the project.

On remittance dates the Panel raised the question, whether CEBS could not have fixed remittance dates (calendar days) so that there would be full harmonisation. CEBS will also consider it. Panel members argued that cross-border banks only have one delivery system for reporting, so the proposal by CEBS to have two different remittance dates for the delivery of the supervisory reports, one for consolidated data and one for solo data, would not make much sense. CEBS will consider this when it received all the feedback on CEBS proposals.

7. Sovereign wealth funds, investing in the EU banks

The issue was raised by the Chair of the Panel, however the Panel decided not to deal with it, given the political sensitivity of the issue and because it is not a specifically supervisory issue.

8. CEBS and 3L3 work programmes:

Kerstin af Jochnick, Chair of CEBS informed the Panel about the transmitting of CEBS work programmes. In the near future, the Level 3 Committees (CEBS, CESR and CEIOPS) will introduce a 2-stage process for transmitting their work programmes. The Level 3 committees will be presenting their future year's draft work programme in the Autumn and then in Spring, reporting on their achievement of their previous year's programme. Therefore it is foreseen that the prioritization exercise in which the Panel is actively participating and assisting CEBS, will be sent to the Panel in

early July and the work programme of CEBS for 2009 will have to be prepared by September 2008.

The date of the next Panel meeting:

- 14 May 2008 (London), hosted by the UK FSA.

The following members and observers of the Panel were present:

Freddy Van den Spiegel (Chair); Richard Desmond; Dr. Siegfried Jaschinski; Dr. Klaus-Dieter Kremkow; Herbert Pichler; Klaus Willerslev-Olsen; Michel Bilger; Hugo Banziger; Bertrand de Saint Mars, Stephen Sanders, Nils-Fredrik Nyblaeus, Jose Maria Alvarez Cedron; Davide Alfonsi; Volker Heegemann (observer); Walburga Hemetsberger (observer); Wilfred Wilms (observer); Kristelle Maouad (representing Christian Lajoie); Christos Pergamalis (representing Demetrios Lefakis); Harry Stordel (representing Andrew Cross).