



9.9.2004

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To the Committee of European Banking Supervisors

## CONSULTATION PAPER ON THE APPLICATION OF THE SUPERVISORY REVIEW PROCESS UNDER PILLAR II

The Committee of European Banking Supervisors published on 24 th May 2004 a third Consultation Paper on the Application of the Supervisory Review Process under Pillar 2.

The Finnish Bankers' Association is a member of European Banking Federation (FBE). While supporting the views put forward in the FBE's comments, the Finnish Bankers' Association respectfully submits the following comments.

### *General remarks*

We believe that the general aim of a separate Supervisory Review Process is to enhance understanding between the supervisor and the supervised entity, of a groups whole risk profile, including its programme of mitigation or capital planning, thereby reducing the probability of prudential failure in a cost efficient manner. To meet this objective, **proposals set out in the paper should deliver a less detailed and more holistic approach to risk management both for supervisors and for supervised entities.** This general approach could be evaluated more specifically via discussions between the supervisor and the supervised entity, subject to change whenever the entity sees that its strategy, organisation or business environment has changed.

We would also like to emphasize, that Pillar II should be an ongoing, dynamic and open dialogue between firms and their supervisors. The responsibility rests with the supervised entity to explain its processes, analysis and actions to the supervisor and to convince the supervisor that its ICAAP is appropriate for its business. The supervisor's role is to challenge the banks risk assessment through the SREP.

### *Level of application*

We believe that in order to align with the group risk structure operating within most firms, **Pillar 2 should only be applied at the consolidated group level.** Application of Pillar 2 at sub-consolidated or solo level would lead to double counting of risks and impede institution's ability to design and implement the ICAAP process as set out in the paper.



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### *Confidentiality*

In certain jurisdictions (including Finland), supervisory authorities are widely publishing supervisory actions addressed to individual institutions. Extending this practise to prudential measures available under Pillar II may lead, taking into account the complex process behind the evaluation process, misinterpretation and could have negative and even irrevocable consequences to an individual institution or its banking group as a whole. Given this background, we would like to stress the **importance of the confidentiality** of the prudential measures available under Pillar II.

### *Diversification*

Principle VIII(g) states that institutions may take into account risk correlations. We see a need to explicitly **recognise that diversification may exist and should warrant capital reductions**. In our view Principle X should also make reference to capital reductions for risk mitigation through diversification.

### *Comparison amongst peer group*

We are concerned with the proposal in Principal XI that firms should make disclosures on their ICAAP model for comparison amongst their peer group. There are dangers inherent in supervisors encouraging too great a degree of uniformity of practice. Particularly this may lead misinterpretation in such small countries, where banking sector is centralized having only limited number of comparable banks. Pillar 2 should have a **systemic value in allowing institutions to exercise a diverse range of measures and management techniques**. Therefore the SRP should be, as stated above, a confidential process.

## THE FINNISH BANKERS' ASSOCIATION

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