

# ZENTRALER KREDITAUSSCHUSS

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## **CP24 Consultation Paper “High-level principles for risk management“**

Ladies and Gentlemen,

We would like to thank you for the opportunity to comment on Consultation Paper CP24 “High-level principles for risk management“. Please find the comments of the German banking industry below.

The Zentraler Kreditausschuss (ZKA) represents the interests of the German banking industry both at a national and at an international level. Its members are the leading German banking associations. On aggregate they represent some 2300 banks and savings banks with a combined balance sheet total of approximately EUR 5 trillion.

We would like to preface our more detailed comments on the proposals contained in the present Consultation Paper by a number of more general remarks.

## **General comments**

We welcome CEBS's intention to consolidate all its principles and guidelines on risk management in one single, consistent document in the future. Unfortunately, at first the CEBS high-level principles are only available as a stand-alone document. Hence, in view of the connecting points to the other guidelines, we fully endorse CEBS's suggestion to incorporate references to the other risk management standards and guidelines.

We also welcome the fact that the present Consultation Paper clearly highlights the principle of proportionality (principle 8 and the corresponding footnote 4).

However, in our view principles are too far reaching because they generally refer to "all risks" of an institution. In order to keep the institutions' workload within reasonable limits whilst at the same time not losing sight of the respective central risks, we would suggest to limit the scope of the principles to "relevant risks". This particularly applies to principles 11, 27 and 32 (which is especially true in view of the fact that principles 13 and 15 themselves make explicit reference to "relevant risks").

## Comments on individual principles

9. ff. On principle, the rationale for requesting an appropriate risk culture within institutions is basically understandable. However, we feel that anchoring the latter in the form of a principle is questionable. After all, it is difficult to conceive of a method for assessing an institution's internal risk culture. We feel that the term "governance", which is geared more to reviewable organisational and operational structure aspects, would better fit for this purpose.

10. The Consultation Paper suggests that "the management body have a full understanding of the nature of the business and its associated risks". Here, it is always necessary to take account of the fact that the management body may feature a work-sharing. After all, also at the level of senior management, the work and knowledge sharing is inevitable.

The next sentence reads "At least some members of the management body [...] should carry out an activity in the area of financial markets or have professional experience directly linked to this type of activity." In order to better reflect the needs of specialised institutions with a narrowly defined scope of business, we should like to suggest prefacing this by adding "Where necessary against the background of business activities".

15. The sentence "In setting a risk appetite or risk tolerance level, the institution has to take all relevant risks to the institution into account" is largely identical with the content under principle 13 and should therefore be deleted. The sentence in paragraph 13 can thus read: "Risk appetite or risk tolerance should take all relevant risks into account, including those arising from off-balance-sheet-transactions." We welcome the fact that, in line with the practice, the terms "risk appetite" and "risk tolerance" are largely used as synonyms.

The second sentence under this principle reads: "Models that indicate that the institution stands to earn very high returns on economic capital may in fact point to deficiency in the models (such as failure to take into account all relevant risks) rather than superior strategy or execution on the part of the institution". We hold the view that this sentence is inappropriate and suggest deleting it. There are indeed business fields where institutions stand to earn very high returns on a limited amount of economic capital, e.g. private banking and payments.

18. As far as the wording “risk measurement should be constantly reviewed and scrutinised“ is concerned, we suggest replacing the word “constantly“ by “regularly“. In practice, a constant review will not be feasible; in the final analysis it will always boil down to conducting reviews in appropriate intervals.

The last sentence reads “even in a stressed economic environment”. This could be misunderstood as meaning that also stress tests will have to be conducted on a day-to-day basis and that the respective results would have to be reflected in the form of cover assets or, moreover, a limit system. We feel that this requirement is not fit for purpose. In our understanding, an institution’s business operations need to be primarily geared towards the normal risk measurement instruments. This is why the latter will also have to be conducted on a day-to-day basis and their results will have to be reflected in the form of cover assets or, moreover, a limit system. Stress tests merely serve to provide a second perspective for assessing an institution's strategic alignment which was thus defined. Depending on an institution’s strategy, the general frequency of stress tests may be clearly lower. What is more, cover assets or, moreover, limit systems for stress tests, are not acceptable. We therefore suggest deleting the expression “even in a stressed economic environment“.

29. In our preliminary understanding the phrase “integrated treatment of risk” means that the institution shall obtain a comprehensive overview over the relevant risks when it decides to launch new products or activities. This does not mean that the respective risks will have to be captured by a risk model on an integrated basis. In terms of the overall subject matter, this principle would appear to be better placed under the next chapter (for instance after principle 35).
30. Pursuant to this principle, risk-taking decisions may not be solely based on quantitative information or model results. Instead, they particularly need to include expert knowledge. Based on the foregoing, we feel there is an urgent need to differentiate between decisions taken in the cause of standard business and other segments, as profitable standard business requires standardised processes to a great extent. Expert judgment and the like can only be used here at aggregated level and not in every individual decision.

The Consultation Paper contains the phrase “such assessments should be formally integrated in material risk decisions”. We feel that documenting also macro-economic assessments for each and every material transaction is unrealistic. Hence, in our view the

scope of this requirement can only extend to fundamental decisions which affect the overall strategic alignment; yet, it may and shall not apply to individual risk decisions within the meaning of business decisions.

32. The expression “on a consolidated basis” cannot mean that the identification, measurement and monitoring of risks has to take place on a consolidated data basis, i.e. under consideration of intra-group consolidation. This would hardly be feasible. It would be better to use, for instance, the expressions “on a common basis” or „on an aggregated basis”.

Feel free to contact us for any further queries.

Yours sincerely,

For and on behalf of  
ZENTRALER KREDITAUSSCHUSS  
Bundesverband der Deutschen  
Volksbanken und Raiffeisenbanken e.V.

i. V.



(Bernhard Krob)