

CEBS's Draft Guidelines for the Joint Assessment of the Elements Covered by the SREP and the Joint Decision on the Capital Adequacy of Cross Border Groups (CP39)

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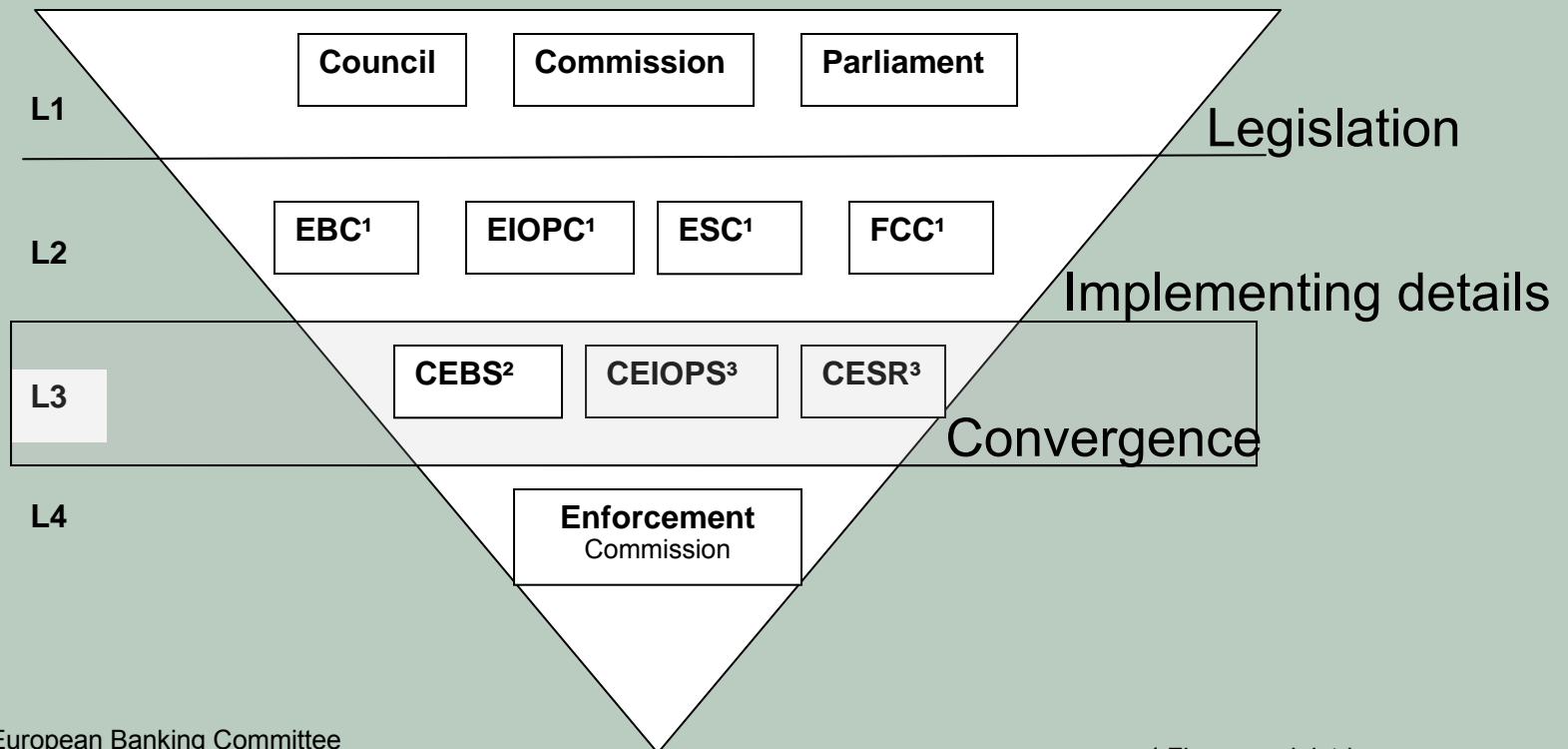
Committee of European
Banking Supervisors

Outline

- **The role of CEBS**
- **Objectives of the draft Guidelines**
- **Cooperation procedure**
- **Main content of the draft Guidelines:**
 - Provided tools for convergence
 - Assessment elements
 - Decision on capital adequacy
- **Implementation**
- **Next steps**

The Role of CEBS (I)

The Lamfalussy structure



EBC = European Banking Committee

EIOPC = European Insurance and Occupational Pensions Committee

ESC = European Securities Committee

FCC = Financial Conglomerates Committee

CEIOPS = Committee of European Insurance and Occupational Pensions Supervisors

CESR = Committee of European Securities Regulators

¹ Finance ministries

² Supervisors and Central Banks

³ Supervisors

The Role of CEBS (II)

Objectives:

Promote efficient and effective supervision and the safety and soundness of the EU financial system through:

- Good and convergent supervisory practices
- Efficient and cost-effective approaches to supervision of cross-border groups
- Level playing field and proportionality

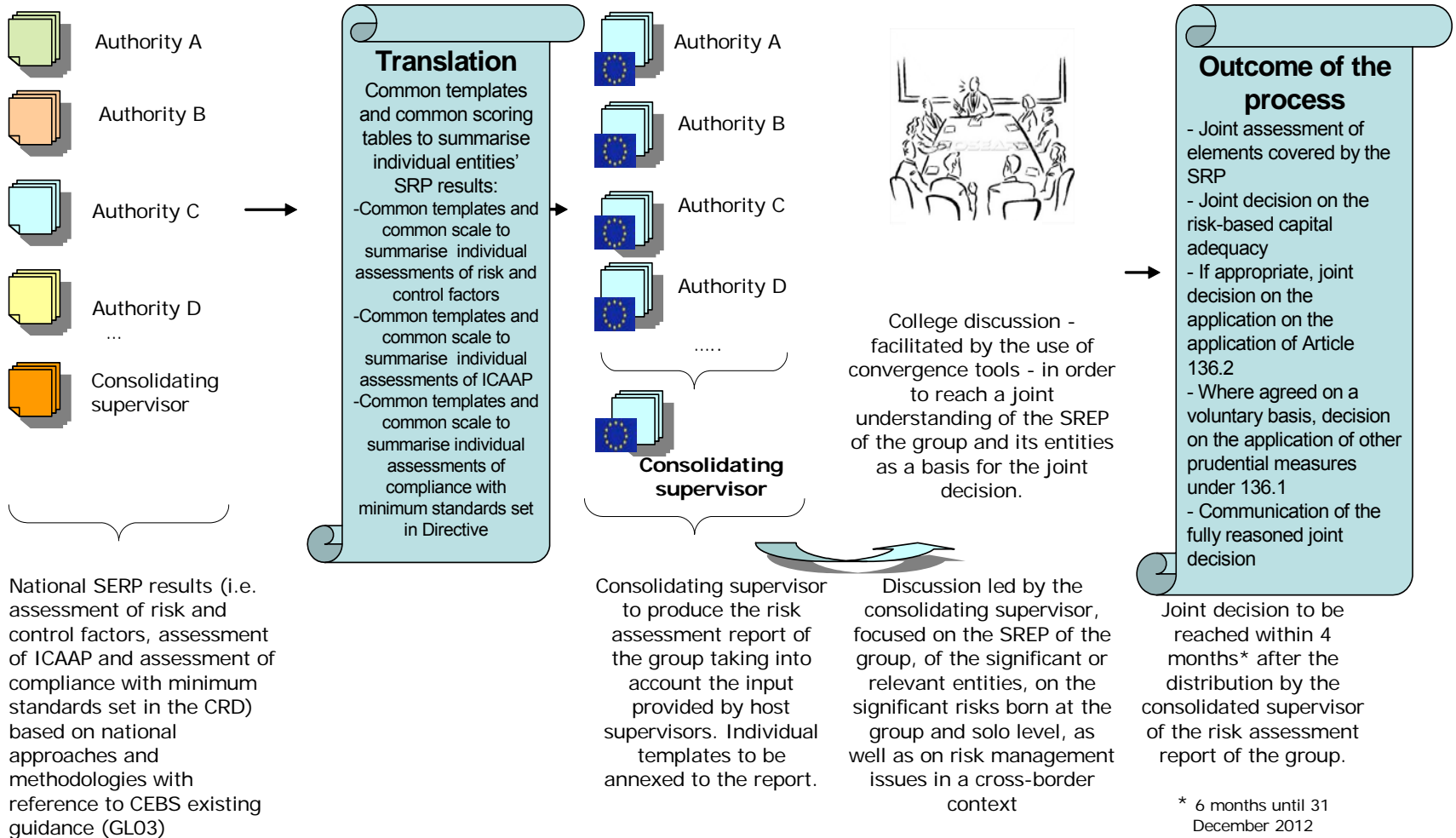
Main tasks:

- Advice to the Commission
- Uniform implementation of the EU banking legislation
- Convergence of supervisory practices and reporting
- Information exchange and supervisory cooperation
- Efficient and consistent functioning of colleges
- EU risk assessment from a supervisory perspective

Objectives of the draft Guidelines

- **Meet the stipulations of the CRD for a joint decision** on the capital adequacy of the group and its entities.
- **Facilitate** the joint decision process and to **avoid inconsistencies** in the approaches followed by the various colleges.
- **Provide tools for** reaching a **shared understanding** of the risk profile and the risk based capital adequacy of the group and its entities.
 - Foster **further cooperation and convergence** and **ensure consistency** on the adequate level of own funds throughout the group.
 - An incentive for **further harmonisation of Pillar 2** approaches and methodologies.

Cooperation procedure (I)



Cooperation procedure (II): Authorities involved in the joint decision

- **Required:** consolidating supervisor and EEA supervisors of subsidiaries, taking into account their relevance for the group and their significance in local markets.
- **Depending** on the group's structure and risk profile: non EEA members of the college and non-banking supervisors.
- Degree of **integration** of the banking group **determines** the degree of **interaction** among college members.
- **CEBS** can be **consulted**.

Cooperation procedure (III): Frequency of the joint assessment and decision

- Joint decision to be updated on an **annual basis** → joint assessment to be reviewed accordingly.
- Host supervisors, in exceptional circumstances may make a **written and reasoned request** to update the joint decision, in case of **major events** impacting the group or its entities.
- Annual assessment **may concentrate on certain areas** provided that all significant changes to the overall risk profile are taken into account.

Cooperation procedure (IV): Outcome of the process

- **Joint assessment** covering:
 - **Risk profile** (risk and risk management and control factors)
 - **ICAAP process and methodologies**
 - **Compliance** with CRD requirements (e.g. Pillar 3 disclosures, ongoing review of internal models)
- **Joint decision** on the risk based capital adequacy:
 - If appropriate, **requirement to hold own funds above the minimum** regulatory level both at the group and solo level
 - College members may also agree **on a voluntary basis** on the application of **other prudential measures** (e.g. improvement of control and risk management framework)

Convergence tools (for the coordination of assessments)

- **Common tables** to report the individual outcomes of the SREP process + **common scoring scales**
- Individual tables to be **annexed to the consolidated report**
- List of **topics** that should be **discussed within the college**
- **Summary tables** for the joint assessment

Assessment elements (I): Joint assessment of risks, risk management and control factors

- Relevant and significant entities
- Material risks (for a certain group, they can differ from the ones in the template)
- Material deficiencies in risk management and internal governance
- Intra-group aspects (transactions, concentration, contagion)
- Cross-border specificities
- Overview of the group's business activities and overall risk profile
- Financial position
- Overall strategy, risk appetite and risk tolerance
- Corporate governance at group and entity level
- Assessment of the main risks

Assessment elements (II): ICAAP framework and compliance with CRD

- Adequacy of ICAAP scope: all relevant entities and risks to be captured
- Adequacy of ICAAP methodologies: output to be reliable
- Adequacy of stress testing framework for capital planning
- Appropriateness of the governance aspects related to ICAAP
- Compliance with minimum requirements for advanced approaches under Pillar 1
- Compliance with disclosure requirements under Pillar 3

Joint decision on risk based capital adequacy

- **Reconciliation** between supervisory risk assessments and ICAAP outcomes
- Treatment of **diversification** effects and allocation of capital across the group
- Capital *buffers* or targets for **stressed conditions**
- **Regulatory capital requirements and internal capital estimates:** drivers behind differences, assessment of internal capital not eligible as regulatory capital, add-on requirements

Implementation

- CEBS will expect its members to apply the present guidelines, once finalised, by **31 December 2010** together with the implementation of the CRD II.
- **CEBS** will **support** the **implementation** of the guidelines by means of workshops for supervisors and presenting the methodology to the colleges of supervisors directly.
- **Methodology** developed in the guidelines is **also used** in the regular **CEBS micro-prudential assessment** of risks and vulnerabilities in the EU banking sector reported twice a year to the EU institutions.
- CEBS will conduct a formal **implementation study** approximately one year later after the implementation date.

Immediate follow-up work and next steps

- Public consultations runs until **9 July 2010**
- Please send your written comments to the following e-mail address: cp39@c-eps.org
- Comments received will be published on CEBS' website unless respondents explicitly request otherwise
- Final version of the document will be available in late 2010



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Annex: common tables, common scoring scales and summary tables in CP 39

1. Assessment of risks, risk management and control factors
2. Assessment of ICAAP framework
3. Assessment of compliance with CRD
4. Assessment of capital adequacy

Assessment of risks, risk management and control factors: common table (I)

1. Business activities and overall risk profile **score:**

Assessment of the general risk profile of an entity/group (narrative information following by main conclusions and deficiencies identified)

2. Financial position **score:**

Assessment of profitability and financial development (narrative information following by main conclusions and deficiencies identified)

3. Overall strategy and risk tolerance **score:**

Assessment of the business strategy and risk strategy of an entity/group (narrative information following by main conclusions and deficiencies identified)

4. Corporate governance including internal governance **score:**

Assessment of the adequacy (including implementation) of the corporate governance and internal governance (narrative information following by main conclusions and deficiencies identified) addressing:

- roles, responsibilities and organisation of the management body(ies);*
- roles, responsibilities, organisation and performance of the internal control framework (risk control function, compliance function, internal audit function).*

Assessment of risks, risk management and control factors: common table (II)

5. Summary table on the assessment of the material risks

Risk types	Score for risk factor assessment, where applicable	Score for risk management and control assessment, where applicable	Combined score ⁵ (assessment of risk and control factors), where applicable	Explanation
Credit risk				
Risks related to risk transfer through securitisation activities				
Market risk				
Operational risk				
Liquidity risk				
Concentration risk				
Interest rate risk from non-trading activities				
<i>Other risks (please specify)</i>				

Assessment of risks, risk management and control factors: common scoring scale (I)

Common scores for the assessment of risk factors

Score	Description
1	Low risk of significant impact on the prudential elements ⁷ of the group or its entities.
2	Medium-Low risk of significant impact on the prudential elements of the group or its entities. Nonetheless, a change in the situation could relatively quickly have a significant impact, and thus the risks or weaknesses considered must be monitored.
3	Medium-High risk of significant impact on the prudential elements of the group or its entities. The entity's risk control thus requires supervisory attention.
4	High risk of significant impact on the prudential elements of the group or its entities. The entity's risk control thus requires heightened supervisory attention.

Assessment of risks, risk management and control factors: common scoring scale (II)

Common scores for the assessment of risk controls

Scores	Description
1	A high level of risk management and control. The risk management and control framework is clearly defined and fully compatible with the nature and complexity of the institution's activities ⁸ .
2	An acceptable level of risk management and control. The risk management and control framework is adequately defined and sufficiently compatible with the nature and complexity of the institution's activities.
3	The risk management and control needs improvement. The risks are insufficiently mitigated and controlled, leaving too high a residual risk for the institution. The risk management and control framework is hardly defined or insufficiently compatible with the nature and complexity of the institution's activities.
4	The risk management needs drastic and/or immediate improvement. The risks are not or hardly mitigated and poorly controlled. The risk management and control framework is neither defined nor compatible with the nature and complexity of the institution's activities.

Assessment of risks, risk management and control factors: summary table

Entity	Entity X (score)	Entity Y (score)	Entity Z (score)	GROUP TOTAL (score)
Business activity and overall risk profile				
Financial position				
Overall strategy and risk appetite and risk tolerance				
Internal governance (incl. internal control)				
Assessment of material risks (using the combined scores)				
Credit risk				
Market risk				
Operational risk				
Concentration risk				
Liquidity risk				
Interest rate risk from non-trading activities				
Business and strategic risk				
Other risks (please specify)				
Major deficiencies and observations	<i>Narrative information</i>			
Conclusions and explanations	<i>Narrative information</i>			

Assessment of ICAAP framework: common table

Entity		
	Score	Explanation
Overall ICAAP score		
<i>Where applicable:</i>		
ICAAP scope, including:		
entities covered (organisational scope)		
risks covered		
ICAAP methodologies, including:		
measurement and assessment processes		
forward looking perspective		
outcomes (capital estimate)		
Diversification assumptions ¹⁹		
Stress testing framework		
ICAAP governance and internal control, including:		
integration into management process		
specification and documentation of the capital policy		
Major deficiencies and observations	<i>Narrative information</i>	
Conclusions and explanations	<i>Narrative information</i>	

Assessment of ICAAP framework: common scoring scale

Scores	Description
1	Methodologies and processes are of good quality. They make it possible to determine a precise and accurate estimate of internal capital needs both overall and per risk type, where applicable.
2	Methodologies and processes are of satisfactory quality. They make it possible to determine an estimate of internal capital both overall and per risk type, where applicable, which - if not precise - is conservative and prudent.
3	Methodologies and processes are of unsatisfactory quality. They potentially underestimate the internal capital needs both overall and per risk type, where applicable.
4	Methodologies and processes are insufficient. They largely underestimate the internal capital needs both overall and per risk type, where applicable.

Assessment of ICAAP framework: summary table

Entity	Entity X	Entity Y	Entity Z	GROUP TOTAL
Overall ICAAP score				
<i>Detailed score (where applicable):</i>				
ICAAP scope, including:				
entities covered (organisational scope)				
risks covered				
ICAAP methodologies, including:				
measurement and assessment processes				
forward looking perspective				
outcomes (capital estimate)				
Diversification assumptions				
Stress testing framework				
ICAAP governance and internal control, including:				
integration into management process				
specification and documentation of the capital policy				
Major deficiencies and observations	<i>Narrative information</i>			
Conclusions and explanations	<i>Narrative information</i>			

Assessment of compliance with the CRD: common table

Entity:			
Topic	Material deficiencies identified	Measures taken or considered	Comments
Advanced approaches under Pillar 1, including ²⁴ :			
Disclosure requirements ²⁵			
Major deficiencies and observations	<i>Narrative information</i>		
Conclusions and explanations	<i>Narrative information</i>		

Assessment of risk based capital adequacy: common table (I)

Entity:					
	Score (1)	Pillar 1 regulatory capital requirements (2) (amount)	ICAAP capital estimate (3) (amount)	SREP capital estimate (4) (amount)	Comments and explanation (5)
Corporate governance (incl. internal governance)			Where applicable	Where applicable	
Financial position			Where applicable	Where applicable	
Overall strategy and risk tolerance			Where applicable	Where applicable	
Business activities and overall risk profile			Where applicable	Where applicable	
Credit risk			Where applicable	Where applicable	
Risks related to risk transfer through securitisation			Where applicable	Where applicable	
Market risk			Where applicable	Where applicable	
Operational risk			Where applicable	Where applicable	
Concentration risk			Where applicable	Where applicable	
Liquidity risk			Where applicable	Where applicable	
Interest rate risk from non-trading activities			Where applicable	Where applicable	
Business and strategic risk			Where applicable	Where applicable	
Other risks (please specify)			Where applicable	Where applicable	
ICAAP score					
Compliance with CRD requirements				Where applicable	
Diversification ³⁴			Where applicable	Where applicable	
Stress testing buffer or target ratio			Where applicable	Where applicable	
Total requirement					

Assessment of risk based capital adequacy: common table (II)

Entity:					
	Available capital	Pillar 1 requirement	ICAAP	SREP	Comments and explanations
Total capital (amount)		<i>Where applicable</i>	<i>Where applicable</i>	<i>Where applicable</i>	
Capital ratio (%)		<i>Where applicable</i>	<i>Where applicable</i>	<i>Where applicable</i>	
Tier 1 capital (amount)		<i>Where applicable</i>	<i>Where applicable</i>	<i>Where applicable</i>	
Tier 1 ratio (%)		<i>Where applicable</i>	<i>Where applicable</i>	<i>Where applicable</i>	
Core Tier 1 capital (amount)		<i>Where applicable</i>	<i>Where applicable</i>	<i>Where applicable</i>	
Core Tier 1 ratio (%)		<i>Where applicable</i>	<i>Where applicable</i>	<i>Where applicable</i>	
Other financial resources to cover ICAAP estimates (amount)					

Decision on risk based capital adequacy: summary table

	Entity X	Entity Y	Group total
Available capital (amount or %)			
P1 requirements (amount or %)			
ICAAP estimates (amount or %)			
SREP requirements (amount or %)			