POSITION PAPER

ESBG Response to
CEBS consultation on
High-level principles for risk management (CP24)

6 July 2009

ESBG

The European Savings Banks Group (ESBG) welcomes the opportunity to comment on the consultative document issued by the Committee of European Banking Supervisors (CEBS) entitled ‘High-level principles for risk management’ (CP24).

General comments

ESBG very much welcomes CEBS’ intention to consolidate all existing principles and guidelines on risk management into a ‘comprehensive guidebook’ corresponding to the structure of Annex V of the Capital Requirements Directive (CRD). This would indeed allow for eliminating overlaps, as well as for offering a compact overview on all aspects of risk management. However, the presentation by CEBS of a separate set of stand-alone overarching high-level principles does, in our view, not correspond to this desideratum of comprehensiveness and consolidation. Furthermore, without knowing the remaining principles and guidelines on risk management, it is only partially possible to assess the principles described in CP24, which will interact in practice substantially with the other principles (e.g. risk modelling and stress testing). Therefore, ESBG recommends that CP24 be supplemented at least with the references to the other principles on risk management.

Moreover, it would be interesting to compile also the risk management principles issued by other fora, such as the Basel Committee. This would allow institutions to find, in a comprehensive document, all-encompassing guidance on both: generic issues related to risk management and specific aspects related to the relevant risks they incur.

In our view the abstract requirement in paragraph 7 that the high-level principles be generally considered by institutions and supervisors is not satisfactory. It should be specified that these requirements apply only to the relevant and material risks of an institution. Reference to the ‘relevant risks’ is already made in paragraphs 13 and 15. ESBG considers that an explicit reference to the ‘relevance’ and ‘materiality’ of risks is particularly important especially in the context of the requirements on governance (paragraph 11); risk identification through models (paragraph 27) and risk management processes (paragraph 32).

Governance and risk culture (paragraphs 9-12)

Fundamentally we can understand the rationale behind the requirement of an adequate risk culture. However, we perceive that it is problematic to raise it to the rank of principle, as the risk culture is in our understanding the result of the establishment of adequate management and reporting processes, and thereby part of the ‘governance’ issue. In addition, it is hardly conceivable how the supervisors could assess the internal risk culture of an institution. Therefore, we would welcome the deletion of references to ‘risk culture’.

Risk appetite and risk tolerance

In paragraph 13, the introductory sentence: 'The level of risk that institutions are willing to take is constrained by regulation and supervision, given that the social cost of any institution failure (official support measure) would typically exceed the limited downside risk for institution shareholders and management' is superfluous. Therefore ESBG urges CEBS to delete it.

ESBG welcomes that the concepts 'risk appetite' and 'risk tolerance' are used by CEBS as being largely synonymous, like in practice. Taking this in consideration, we observe that the requirement in paragraph 15 asking an institution to take into account all relevant risks when setting a risk appetite or risk tolerance level is overlapping with the requirements in paragraph 13. We therefore would recommend that the redundancy be deleted and paragraph 13 be completed as follows: '<u>Risk appetite or</u> risk tolerance should take all relevant risks into account, including those arising from off-balance-sheet transactions.'

ESBG believes that also the second sentence in paragraph 15 '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' should be deleted. On the one hand, there are certain fields of activity with little need for capital that may produce high returns (such as private banking). On the other hand, it is not necessary to warn about the performance or deficiencies of the models in use, especially as there are other principles in the document addressing the issue of over-reliance on models (see for instance paragraph 28).

Furthermore, ESBG considers that expecting 'constant' review and scrutiny of risk measurement as demanded in paragraph 18 is not realistic. We urge CEBS to revise the wording and request for 'regular' review instead.

The role of Chief Risk Officer (CRO) and the risk management function

It is correct to underline that both, the CRO and the risk management function should have expertise, which matches the institution's risk profile (paragraphs 21 and 22). However, as in practice this happens at the same time, we would suggest that at least the first two sentences in paragraphs 21 and 22 are brought together and then followed by the description of the different tasks to be performed by the CRO and, respectively, the risk management.

Risk models and integration of risk management areas

We understand the wording 'integrated treatment of risk' in paragraph 29 in the sense that an institution has a broad overview of the relevant risks related to the launch of new products or activities. This does not mean however that the correspondent risks should be integrated into a risk model. From the perspective of the topic addressed, this principle would better fit under the last section on 'New product approval policy and process' (after paragraph 35).

The content of the principle contained in paragraph 31 is largely corresponding to the requirements in paragraphs 11 and 12. Therefore, we would recommend that the principle be moved into the section on governance.

About ESBG (European Savings Banks Group)

ESBG (European Savings Banks Group) is an international banking association that represents one of the largest European retail banking networks, comprising about one third of the retail banking market in Europe, with total assets of € 5967 billion (1 January 2008). It represents the interest of its Members vis-à-vis the EU Institutions and generates, facilitates and manages high quality cross-border banking projects.

ESBG Members are typically savings and retail banks or associations thereof. They are often organized in decentralized networks and offer their services throughout their region. ESBG Member banks have reinvested responsibly in their region for many decades and are one distinct benchmark for corporate social responsibility activities throughout Europe and the world.

European Savings Banks Group - aisbl
Rue Marie-Thérèse, 11 B-1000 Brussels Tel: +32 2 211 11 11 Fax : +32 2 211 11 99

Info@savings-banks.eu www.esbg.eu

Published by ESBG. July 2009