4 DEVELOPMENTS IN INTERNATIONAL BANKING REGULATION AND SUPERVISION FORA

4 Developments in international banking regulation and supervision fora

One of the Banco de España's strategic objectives is to heighten its international presence and projection in order to widen its influence in the international fora where decisions are made on regulatory and supervisory matters of interest to Spanish credit institutions. The financial crisis, which began in summer 2007 and is affecting, to a greater or lesser extent, the financial stability of all countries, requires solutions designed, taken and implemented globally. This means that it is important for dialogue with the other central banks, supervisors and regulators to be appropriate and fluid.

In general terms, the work of international committees in 2008 has reflected the need to analyse the causes, consequences and lessons of the crisis, and to seek appropriate solutions which will restore confidence and financial stability and prevent a crisis as serious as this one from being repeated in the future (see Box 4.1).

The Financial Stability Forum report approved by the meeting of G7 ministers and central bank governors in April 2008 proposed specific actions and tasks to the various committees, including those of bank supervisors. The same can be said of the declaration of the G20 summit held in Washington on 15 November, which approved a specific action plan. In this summit a commitment was made to improve cooperation and work together to identify and implement the reforms needed to improve the functioning and solvency of world financial systems.

Europe has followed a parallel process to that in train at global level, albeit including certain additional features reflecting European needs. This additional work was included in the roadmaps on market turbulence and on financial stability and crisis management established by the ECOFIN in October 2007, most of which were completed during the course of 2008. In addition, as a result of the G20 summit, the Economic and Financial Committee, under an ECOFIN mandate, prepared a work programme incorporating the points of the G20 action plan.. This programme is intended to contribute to the work carried out in different international fora and to prepare a European contribution to the coming G20 summits.

It has, thus, been decisions at the highest political level that have shaped the agendas of the international committees of financial regulators and supervisors, although much of the work requested had already been started by these committees.

The remaining sections of this chapter describe the work of the international committees of regulators and supervisors in which the Banco de España participates actively at European and global level, including that relating to regulation and supervision of both a prudential and an accounting nature. Also included is a description of the work carried out jointly by the committees of bank, securities and insurance supervisors, as well as an account of the financial stability work of the European Central bank and the work of the ASBA.

Table 4.1 gives information on the number of groups and subgroups (more than 70) which report to the various committees and which held 236 meetings in 2008, substantially (20%) more than in 2007. The fact that this was basically due to the increase in the meetings having to do with the BCBS evidences its leadership in the work on the lessons learned from the crisis. Nevertheless, the principal heading to which supervisory resources were devoted continued to be the Committee of European Banking Supervisors, since it accounted for 40% of the international meetings in which the Banco de España participated.

ACTIVITY OF SUPERVISORY COMMITTEES IN 2008 TABLE 4.1

Number (a)

	GROUPS	MEETINGS
Committee of European Banking Supervisors (CEBS)	**26**	**95**
Groupe de Contact (GdC)	7	33
Expert Group on Capital Requirements (EGCR)	9	22
Expert Group on Financial Information (EGFI)	6	27
Other	3	9
Interim Working Group on Financial Conglomerates (IWCFC)	**6**	**20**
Banking Supervision Committee (BSC)	**12**	**31**
Working Group on Macroprudential Analysis (WGMA)	3	7
Working Group on Banking Developments (WGBD)	3	9
Other	5	11
Basel Committee on Banking Supervision (BCBS)	**25**	**80**
Policy Development Group (PDG)	15	50
International Liaison Group (ILG)	2	4
Accord Implementation Group (AIG)	3	11
Accounting Task Force (ATF)	4	11
JOINT FORUM	**3**	**10**
TOTAL	**72**	**236**

SOURCE: Banco de España.

a. The numbers for each committee include the individuals in the groups reporting to the committee and the committee members.

Lastly, albeit no less importantly, was the increase in tasks to bolster international technical cooperation in banking supervision. These tasks included attending to and receiving delegations of foreign supervisors and those involving the participation of Banco de España members as speakers in national and international seminars for supervisors from other countries.

4.1 The work of the Committee of European Banking Supervisors (CEBS)[1]

The CEBS further stepped up its activity in 2008, centred on the four areas described below.

Tasks involving technical advice to the European Commission accounted for, yet another year, a considerable portion of the CEBS's resources. Noteworthy were its contributions to the changes under way in banking solvency directives in regard to five matters for which specific recommendations are made: own funds (common understanding of the characteristics required of hybrid equity instruments qualifying for inclusion in tier 1); large exposures (substantial simplification of the regime, clarifying the elements which may not be compatible with the new solvency rules and reducing many of the existing national discretions); liquidity (recommendations on the management and supervision of this risk); options and national discretions in the new solvency rules (proposing the elimination of a large number of them to achieve the greatest possible convergence in their transposition to national law); and early intervention (the different measures and powers available to national supervisors of EU countries were analysed to ascertain the existing convergence options, particularly in the case of distress of a transnational bank).

1. Table A.6.1 of the Internet version of this Report on the Banco de España website lists the documents on advisory matters and the standards and guidelines published by the CEBS in 2007.

In regard to cooperation in and convergence of supervisory practices, the CEBS continued devoting efforts to real convergence of practices and closer relations between national supervisors. Guidelines were published on liquidity, transparency and valuation management, on operational risk (compendium), on common supervisory financial statements and on communication of bank passports.

Mention should be made of the work on colleges of supervisors. In this connection, the supervisory networks were strengthened, notably through the Subgroup on Operational Networks (SON, reporting to the CEBS), a template was approved for written cooperation and coordination agreements between supervisors and a tool was developed to monitor how well they function. Also, the CEBS is entrusted with monitoring and issuing operating guidelines for the colleges set up and with creating a network of colleges for internationally active banks.

Likewise, the CEBS continues working to achieve harmonised prudential statements for financial reporting (FINREP) and capital requirements (COREP). in this respect, 2012 has been set as the deadline for introducing a uniform report at European level, taking into account the transposition date of Solvency 2 and a certain period for adaptation of the procedures.

Further, peer reviews are considered an important convergence mechanism, for which the CEBS has created a working group – the Review Panel – whose purpose is to encourage supervisory convergence by assessing the application of guidelines. It carried out its first pilot assessment in 2008 of CEBS guidelines on the implementation, validation and assessment of advanced measurement approaches to credit risk and operational risk.

The work relating to the financial crisis has occupied much of the CEBS's agenda, particularly in regard to the monitoring of financial market developments and of national stabilisation plans. Noteworthy in this connection were, inter alia, the survey conducted at the beginning of 2008 on the impact of the financial turmoil on EU institutions, the report analysing the implications of national rescue plans, the creation of a risk management task force chaired by Spain and the publication of a report on the valuation of illiquid financial instruments and the comments on work by the IASB (see Box 4.1).

Also, the CEBS, like the other two supervisors' committees – the CESR for securities and the CEIOPS for insurance – was entrusted by the ECOFIN with preparing a six-monthly report identifying the trends, risks and vulnerabilities of the banking sector, particularly those with a potential impact on financial stability, and the possible measures to be taken. The CEBS prepared this report with the support of the ECB Banking Supervision Committee (BSC), with which it has been working on the design and implementation of a consistent analysis and operational framework encompassing the macro- and micro-prudential factors for this exercise.

Lastly, the CEBS has adapted its own functioning within the framework of the review of the Lamfalussy approach, as explained in detail in Box 4.2.

4.2 Work of the Basel Committee on Banking Supervision[2]

In the opening months of 2008, the Committee continued the work started in 2007 on implementing Basel II and analysing the causes, consequences and lessons of the financial crisis. Also, the April report of the Financial Stability Forum (FSF) proposed specific actions, some relating to the need to strengthen those elements of the Basel II framework in which, in light of the lessons drawn from the current situation, there was considered to be room for improve-

2. Table A.6.3 of the Internet version of this Report lists the documents published by the BCBS in 2008.

In October 2007, the G7 Finance Ministers and Central Bank Governors asked the Financial Stability Forum (FSF) to analyse the causes of the financial turmoil that appeared in July 2007 and make recommendations on how to strengthen the markets and institutions.

In its report published in April 2008, the FSF included a broad list of recommendations in five areas: i) strengthened prudential oversight of capital, liquidity and risk management; ii) enhanced transparency and valuation of financial products; iii) changes in the credit rating agencies; iv) strengthened authorities' responsiveness to risks; and v) agreements between regulators for dealing with stress in the financial system.

In 2008 the financial crisis intensified and spread to the emerging economies. Accordingly, a summit of the G20 countries (G7 plus emerging countries) was organised in Washington, on 15 November 2008, to search for global solutions to the crisis. In the closing statement, the G20 leaders undertook to work together to identify and implement the reforms necessary to enhance the functioning and solvency of the world's financial systems. A detailed action plan was included, with immediate tasks to be completed by end-March 2009 and other tasks for the medium term. Most of the points contained in the action plan already featured in the FSF's recommendations and were under discussion by the international banking, securities and insurance committees, accounting regulators and the financial services industry. Some of the points, however, represented new tasks.

On 2 April 2009, the G20 leaders met again at the London summit[1] to review the work scheduled to have been completed and the validity of the decisions taken in Washington. According to the final communiqué, work is under way to implement the action plan agreed in Washington and, in particular, the specific measures to: strengthen prudential oversight and international cooperation; extend regulation to all systemically important financial institutions, instruments and markets; establish effective supervision of the credit rating agencies; and improve remuneration systems and accounting standards. In addition, a new Financial Stability Board was created, as a successor to the FSF, comprising all the G20 countries, the FSF members, the European Commission and Spain.

In the area of banking regulation, the Basel Committee on Banking Supervision (BCBS) is responsible for implementing the FSF's recommendations and the plan of action contained in the G20 Declaration of November 2008 and confirmed in the G20 Declaration of April 2009. For this purpose, the Committee established the following priorities in its work programme: strengthen capital requirements; implement and enhance liquidity risk management; foment improvements in risk management and supervision at financial institutions; enhance market disclosure and transparency; improve supervisory cooperation for international banks; and, lastly, strengthen the macro-prudential approach to supervision.

In January 2009, the BCBS published a consultative package of measures. Under Pillar 1, higher capital requirements are proposed for certain complex products, such as re-securitisations and liquidity lines extended to support ABCP conduits, and for instruments included in the trading portfolio. Under Pillar 2, standards are proposed to promote more rigorous supervision and management of risk concentrations, off-balance-sheet exposures, securitisations and the associated reputational risks. Improvements are also proposed in the valuation of complex instruments, in liquidity risk management and in appropriate stress testing practices in banking groups. Lastly, under Pillar 3, improvements are proposed in the market disclosure requirements for institutions on their securitisations and off-balance-sheet vehicles. Moreover, in December 2008, the BCBS's Bank Resolution Group published an interim report reviewing the regulations on bank resolution and their application beyond national borders.

The BCBS has not overlooked its medium-term tasks. The first objective is for banks to have higher liquidity and capital cushions; others are concerned with promoting healthier risk management and corporate governance practices, limiting risk concentrations within and between credit institutions and enhancing market disclosures.

In the accounting field, the IASB, which is not a supervisory committee but which plays an important regulatory role in the area of accounting standards, was obliged to give priority to the work relating to the recommendations included in the FSF's report. Specifically, these related to: 1) fair value accounting for financial instruments; 2) consolidation, to strengthen and improve the requirements for identifying which entities a company controls; 3) the criteria for derecognising instruments in the case of securitisation; 4) notes to financial statements, to improve the information available on fair value accounting for financial instruments and liquidity risk; 5) reducing the complexity of IAS 39; and 6) global convergence of accounting standards, for which purposes the IASB has set 2011 as the target date for completion of the projects included in the Memorandum of Understanding with the FASB.

Regarding the Trustees of the IASB, a strategy review was conducted in 2008, partly at the behest of the ECOFIN, to assure better representation of the European Union, and partly because reform of IASB governance, including a review of its membership to foster financial stability and transparency, formed part of the action plan that came out of the G20 summit in November.

In Europe, developments have paralleled those seen globally. Thus, in October 2007, the ECOFIN agreed on a series of measures and drew up a work programme, with a road map on the financial turmoil with similar objectives to those described above.

Following the G20 summit, the ECOFIN instructed the Economic and Financial Committee to draw up a new work programme to prepare the European presidency's contribution at the next G20 summits.

The Committee of European Banking Supervisors (CEBS) also adapted its work programme to reflect the points in the G20 action plan that affected it, working, among other matters, on colleges of supervisors, remuneration of employees, valuation, liquidity and procyclicality of capital.

1. Spain was invited to take part in both summits.

ment. The Committee naturally altered its work plan to include those proposals of the FSF which had not already been included.

Also in April it made public the matters considered most urgent, on which it planned to work rapidly to have its proposals ready by the end of the year. Hence in January 2009 the Committee published for public consultation a package of measures relating to the three pillars of the Accord. They are included in Box 4.1, which describes the measures taken to deal with the crisis.

In November the Committee announced its medium-term strategy to prevent the deficiencies which led to the crisis from being repeated in the future.

All this was not allowed to distract attention from the need to implement the new capital accord (Basel II) at international level and to monitor its impact on institutions' capital requirements and its possible procyclicality. The full implementation of Basel II will help to remedy many of the weaknesses of Basel I highlighted by the financial crisis. Thus the introduction of the three pillars provides more tools for supervisors and for the market, and ensures that the solvency regulators are better equipped to handle periods of rapid financial innovation and the resulting creation of new products.

Also, work continues on the means to improve cooperation between supervisors in the area of international bank supervision, through the implementation of colleges of supervisors, and in the analysis of problems arising in the implementation of Basel II. The importance of ensuring that supervisory standards and the Committee's recommendations/guidelines are implemented in practice was acknowledged. Accordingly, the Committee decided that the Accord Implementation Group (AIG), chaired by the Banco de España, would change its mandate and be renamed as the Standards Implementation Group (SIG).

In the area of accounting, the Committee continued working to ensure that international accounting and audit standards foster suitable risk management and to support market discipline through greater transparency of institutions. It worked on an accounting analysis of the implementation of Basel II, fair value, credit risk provisions, and the quality of bank external audits and their importance in market discipline and as supervisory support.

Lastly, the International Liaison Group (ILG), created to foster dialogue with supervisors not included in the BCBS, continued to act as a forum for discussion of issues relating to cooperation, information exchange and supervisory collaboration. Most notable in this group's work were its analyses of risk-based supervision, the importance of adequate accounting provisions and microfinance.

4.3 Joint work by banking, securities and insurance committees

The financial crisis has highlighted the growing interrelationships between sectors and between countries as a result of the activities of financial groups. It should thus come as no surprise that the volume of projects being analysed by supervisors of the three sectors grew notably in 2008.

Noteworthy in Europe are the projects on the supervision of financial conglomerates undertaken by the Interim Working Committee on Financial Conglomerates,[3] which reports to the CEBS and to the CEIOPS. These projects focused on completing the joint analysis of the definition of capital in banking and insurance and on commencing the review of the financial conglomerates directive. Also, a stability report was drafted on financial conglomerates in the

3. In 2009 this committee changed its name to the Joint Committee on Financial Conglomerates.

THE EUROPEAN SUPERVISORY STRUCTURE: IMPROVEMENTS TO THE LAMFALUSSY APPROACH, AND THE LAROSIÈRE REPORT

BOX 4.2

The first full review of the functioning of the Lamfalussy approach[1] in the three financial sectors was completed in December 2007. As a result, several improvements were identified and included in the ECOFIN road map of 4 December, which was reviewed and updated in May 2008. The work conducted in the past year, which mainly affects the supervisory committees,[2] includes, in particular, the following:

– Amendment of the charters of the supervisory committees, to include the possibility of using qualified majority voting and to introduce the "comply or explain" mechanism, to oblige those not adopting the decisions taken to publicly explain why not. Moreover, application of the committees' guidelines, recommendations and standards at the national level is strengthened through the peer review process.

– Strengthening of the accountability mechanisms, via submission to the Commission, the Council and the European Parliament of the annual work programmes of all three committees and the joint medium-term programme.

– Adoption of common formats for transposition and implementation at national level of Community legislation, including in particular the CEBS supervisory transparency framework used by the CESR and the CEIOPS for development of their own frameworks, and the drafting of transposition tables by the COM.

– Amendments to the Solvency 2 directives and the CRD proposed by the COM, requiring that Member States' supervisory authorities consider the European dimension in the exercise of their duties, in terms of cooperation and convergence, and financial stability.

– Work conducted by the COM, with the backing of the supervisory committees, on the Member States' sanctioning powers, on supervisory objectives and powers, on use of the voluntary delegation of tasks, on powers for ensuring cooperation and exchange of information between supervisors and on the possibility of including the funding of certain specific tasks of these committees in the European budget.

In parallel with this work, the COM reviewed the decisions taken to establish the supervisory committees, specifying their tasks in areas such as mediation, information exchange or cooperation between financial sectors, and their role in identifying, monitoring and assessing risks to financial stability.

Nevertheless, and despite the progress made, as a result of the financial crisis it was decided to speed up supervisory reform in Europe. In October 2008, the COM president established a high-level group, made up of seven independent experts and chaired by Jacques de Larosière.[3] The group was tasked with presenting specific proposals for strengthening European supervisory agreements in all the financial sectors, thus making for a more efficient, integrated and sustainable supervision system.

The report of the Larosière Group, published on 25 February 2009, analyses the causes of the crisis and the weaknesses of the present system and makes 31 specific recommendations on regulatory, supervisory and global aspects, the most important of which affect the future structure of European financial supervision at both the micro- and macro-prudential level.

In the area of micro-prudential supervision, the report proposes a gradual two-phase approach, to conclude with the establishment of a European System of Financial Supervision (ESFS), which would, in 2011/2012, transform the present level 3 committees into European supervisory authorities, with the power to make binding decisions in certain supervisory matters. Nevertheless, national authorities will retain responsibility for supervision of individual institutions.

In the case of macro-prudential supervision, which is directly connected to financial stability, the ECB is given an important role. The report proposes creating a European Systemic Risk Council (ESRC), under the auspices of the ECB, to reinforce the role of macro-prudential supervision and with the power to prioritise any risks detected so that steps are taken by the corresponding European authorities.

The report's main conclusions include the need, revealed by the recent financial crisis, to strengthen macro-prudential supervision and its links with micro-prudential supervision, and to strengthen and make changes in the supervisory committees. However, there are still many aspects and details pending, and these will doubtless be a topic for discussion at future European supervisory fora in coming months.

1. See Box 4.1 of this Report on Banking Supervision in Spain, 2008. **2.** The so-called level 3 committees: CESR (securities), CEBS (banking) and CEIOPS (insurance).

3. Managing Director of the IMF from 1978 to 1987 and governor of the Banque de France from 1987 to 1993.

European Economic Area and a survey was conducted of the main conglomerates in each country to ascertain whether the financial turmoil had led to an increase in transfers of liquidity within conglomerates. In addition, there was a notable increase in the volume of projects undertaken jointly by European supervisors of the three "level 3 committees" (3L3) from a cross-sectoral standpoint, which included delegation of tasks and/or responsibilities, rating agencies, corporate governance, financial conglomerates and the preparation of guidelines on mergers and acquisitions and on impact assessments.

In the global arena, the Joint Forum published several reports in 2008 analysing issues at the epicentre of the financial crisis: risk concentrations,[4] which analyses the processes developed by financial groups to identify, measure and manage risk concentrations globally; and customer suitability in the marketing of financial products and services,[5] which represents the first common approach to how banking, securities and insurance supervisors address the marketing of certain financial products to retail customers and the possible derived risks for institutions in the event that certain suitability criteria are not met. Lastly, mention should also be made of the work by the Financial Conglomerates Group on the degree of implementation of the 1999 principles in financial conglomerate supervision.

4.4 Work on financial stability in the ECB[6]

As a member of the European System of Central Banks (ESCB), the Banco de España continued to participate actively in the work of the various committees and working groups reporting to the ESCB, including the Banking Supervision Committee (BSC), which works in the field of financial stability.

Since inception of the BSC, financial system developments have heightened the importance of matters relating to financial stability and, consequently, led to an increase in this committee's workload. This trend became more marked in 2008 as a result of the financial crisis, which also largely shaped the BSC's agenda in 2008.

In the area of monitoring of structural and conjunctural developments in the financial system, the BSC prepared its regular reports on banking structures and banking sector stability and contributed to the ECB financial stability report. Deeper analyses were carried out of matters of special interest, including most notably the "originate and distribute" model, the behaviour of the covered bond market and the bank practices in regard to stress tests and contingency plans. In the area of analysis of the impact of prudential regulation on financial stability, the work done jointly with the CEBS on the procyclicality of the new Basel accord may be highlighted. In regard to cooperation between central banks and supervisory authorities, the BSC worked in concert with the CEBS to develop a common analysis framework to assess the systemic implications of a crisis. Finally, a joint initiative in conjunction with the Statistics Committee and the CEBS was undertaken to harmonise statistical and prudential reporting requirements for institutions.

4.5 ASBA

In 2008 the Banco de España further stepped up its cooperation with the ASBA, which groups together banking supervisors in the Americas. The Banco de España, as an associate member since October 2006, participates actively in the governing bodies of the Association and in its empowerment plans, working groups and other activities.

In 2008 the Banco de España participated in the ASBA working group on consolidated supervision entrusted with publishing the final document. In February 2008 a working group on operational risk in banks, chaired by the Banco de España, was set up. Its objective is to define general operational risk management guidelines to serve as a basis for the regulation and supervision of this risk in Latin America. Lastly, in June 2008 a group was created to develop a financial market information system for the region; the Banco de España is also a member of this group.

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4. Report entitled "Cross-sectoral review of group-wide identification and management of risk concentrations" (April 2008). **5.** Report entitled "Customer suitability in the retail sale of financial products and services" (April 2008). **6.** Table A.6.2 lists the documents concerning financial stability published by the ECB in 2008.

In the area of empowerment, seminars were held on the following four topics: international financial reporting standards, in Panama in February; validation of advanced credit risk models, in Colombia in April; keys to the implementation of Basel II standardised approaches, in Chile in June; and Basel Pillar 2, in Mexico DF in November.

Within the framework of cooperation with the ASBA on training, for the second time Latin American countries were offered five places on each course given under the continuous training programme of the Banco de España's Directorate General Banking Supervision. Supervisors of several Latin American countries attended courses organised under this programme.