

International cooperation in the area of ongoing banking supervision

Supervisory colleges are an important element of global and European cooperation between national supervisory authorities. These groups review the implementation of rules, strategies, processes and control mechanisms for an entire banking group. In their function as a platform for discussion and coordination, they are the point of initial contact for the consistent application and enforcement of supervisory regulations and guidelines throughout the European Union. Besides reaching a joint decision on the approval of advanced risk models in colleges of supervisors, another goal in the EU is to achieve a common understanding on measures for compliance with minimum capital requirements at group level based on a joint risk assessment.

Current initiatives being conducted by international bodies such as the G20, the Financial Stability Board and CEBS are strengthening the role of colleges of supervisors. This involves a certain standardisation of operating procedures which – to the extent that this is based on existing commonalities and still permits the necessary scope for flexibility – is to be welcomed. What is pressing, however, is that the guidelines, standards and basic principles that are to be developed at the global and European levels be as coherent as possible without overly restrictive regulations leading to efficiency losses.

Development of international cooperation

Deregulation and liberalisation since the 1980s have led to international integration of banking system

The increasing deregulation and liberalisation beginning in the mid-1980s gave banks round the world new opportunities for growing international diversification. In the EU, moreover, the Single Market and the creation of a "European Passport" for financial institutions fostered an increase in international banking activity as well as mergers and acquisitions across national borders.

Basel Committee as the starting point for minimum level of harmonisation of banking regulation ...

Efforts to harmonise banking supervision launched with the Basel Committee's agreements and accords and the subsequently adopted European rules were initially designed to achieve an internationally coordinated and harmonised minimum level of regulation of banks' business risks at single-entity and consolidated level. The introduction of Basel III meant not only the creation of risk-sensitive capital requirements in Pillar 1; at the same time, the Supervisory Review Process (Pillar 2) and disclosure requirements (Pillar 3) extended supervisory activity considerably. Moreover, in many areas the formulation of internationally agreed basic principles and guidelines makes an important contribution to the creation of a "level playing field" for banks and supervisors alike.

... creates flexibility

The principle of minimum harmonisation of regulation, however, involves flexibility which arises from the existence of areas that are not subject to uniform regulation (such as, up to now, liquidity regimes) as well as from national options and discretions within the existing regulatory framework. Moreover, cross-border

consolidation creates new fields which require regulatory coordination wherever a bank's core functions fall under a different national supervisory jurisdiction (through the transfer of tasks and processes). This aspect is becoming highly important, especially against the background of the current discussion on how supervisors should respond to the financial crisis. It is the crisis that has clearly shown just how necessary it is for national supervisors to exchange such information.

International cooperation among supervisory authorities has existed for quite some time at various levels. The ongoing supervision of large, internationally active banks has been witnessing an increase in cross-border contact between supervisors – through, for instance, international supervisors' conferences as well as, just recently, institutionalised "supervisory colleges". During the process of Basel III implementation, these were recommended by the Accord Implementation Group¹ of the Basel Committee on Banking Supervision as a platform to encourage the consistent implementation of Basel III. This underlying concept of inter-supervisory cooperation was adopted in Article 131 of the "Banking Directive"² of 2006. The article provides for written coordination and cooperation agreements to govern the simplified supervision of cross-border institutions.

Supervisory colleges not new; established in several waves, both globally...

¹ In January 2009, the Accord Implementation Group was migrated to the Standards Implementation Group (SIG).

² Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast).

*... and recently
strengthened ...*

Quite a few new supervisory colleges have been established recently. This is partly in reaction to the catalogue of recommendations issued by the Financial Stability Forum (FSF; now the Financial Stability Board (FSB)),³ which suggested that supervisory colleges be formed for the largest internationally active banks. The G20 global financial summit in Washington DC in November 2008 took this recommendation on board. Moreover, it called for a regular exchange of information between the largest banks and their responsible colleges on their business activities and risk situation.

*... as well as at
the European
level*

At EU level, too, the member states have undertaken to recognise the FSF recommendations. Although the Banking Directive already contained provisions governing supervisory colleges from the outset, the new Article 131a inserted into the Banking Directive in 2009 now requires supervisory colleges to be established for all cross-border institutions by the end of 2010. This requirement to establish such colleges rests with the home supervisor of the respective group parent company – known as the “consolidating supervisor” – and serves to accomplish the tasks listed in Articles 129 and 130 (1) of the Banking Directive: to plan and coordinate supervisory activities in going concern and emergency situations, to reach a joint decision on the validation of internal models and the adequacy of own funds on a consolidated and solo basis⁴ and to alert other authorities in an emergency case.

Even though the activities of supervisory colleges are primarily designed for ongoing

supervision of going concerns, supervisory colleges are equally able to play a key supporting role in explicit crisis prevention. The “FSF Principles for Cross-Border Cooperation on Crisis Management” require a close link between the existing college structure of the specific institution and the work on preparing crisis management in the event of stress.

Supervisory colleges have a supporting role in crisis management – through the use of the platform for exchanging, processing and providing information created by these colleges. The Memorandum of Understanding⁵ adopted in 2008, moreover, envisaged the establishment of “Cross-Border Stability Groups” (CBSGs) above and beyond the intended information and cooperation requirements. These groups include as members not only the supervisory authorities but also the central banks and finance ministries of the participating countries. The CBSGs can refer to specific cross-border banking groups or encompass multiple countries which – for instance, owing to existing interlinkages – share a common interest in maintaining financial stability. This shows that these bodies create an interwoven network of relationships between participating institutions. It is possible for institutions to be members of several of these groups simultaneously. It is therefore important to make sure that the es-

*Role of
supervisory
colleges in crisis
prevention*

*Cooperation
with crisis
management
groups*

³ See Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience, April 2008.

⁴ In the event of a failure to reach an agreement, however, it is the responsible supervisor that takes the final decision with regard to subsidiaries.

⁵ See Memorandum of Understanding on Cooperation between the Financial Supervisory Authorities, Central Banks and Finance Ministries of the European Union on Cross-Border Financial Stability, ECFIN/CEFCPE(2008)REP/53106 REV REV, Brussels, 1 June 2008.

established networks are also manageable in practice and do not create excessive coordination requirements. In addition, an overlap between supervisory colleges and the CBSGs needs to be avoided. However, a key trait shared by supervisory colleges and the aforementioned crisis management groups is that they do not have any decision-making powers in an emergency. Rather, the important decisions, the consequences of which are in some cases severe and could entail major fiscal implications, are taken by the competent national authorities.

Overview of existing supervisory colleges

Organisation of and participation in supervisory colleges

To date, global supervisory colleges have been established for more than 30 internationally active groups of banks and financial services institutions. Within the EU, there are currently already 36 supervisory colleges⁶ for cross-border banking groups. Germany is involved in three global and three EU supervisory colleges as the consolidating supervisor and in 12 global and 15 EU colleges as the host supervisor.

Many different types of supervisory colleges: breakdown by number of participants, ...

There are fundamentally two different basic types of supervisory colleges with respect to their size. "General colleges" represent a sort of "general meeting". The supervisors of subsidiaries and any systemically relevant branches convene, chaired by the consolidating supervisor. Following on from the revision to the Banking Directive (CRD II), the role of supervisors of systemically relevant branches in the EU was expanded very considerably. Now the host supervisor takes the ultimate

decision on the relevance of a branch for its banking system and thus on its membership in the college. The discussion typically encompasses a broad range of issues; the main areas covered by the general colleges include developing a common understanding of the banking group's strategic orientation and the associated risk profile and also organisational concerns.

In accordance with international standards, the consolidating supervisor also has the option of creating a supplementary "core college" with a smaller group of members⁷ so that specific themes can be discussed in more detail efficiently. Such theme areas include quantitative aspects of capital and liquidity (including stress testing and the planning thereof) and details concerning supervisory risk assessment.

There are many other ways to differentiate such colleges besides the number of participants. For instance, they may be organised based on regions or business lines, taking into account supervisory requirements or requirements imposed by the organisation of the banking groups. The variability of the multiorganisational approach ensures a high level of compliance with these requirements. Imposing a uniform structure, or a set of such structures, conversely, would pose the threat of information losses and frictional losses and therefore quality losses. In the EU, there is a

... by focus, ...

... by regions and by business lines

⁶ The Committee of European Banking Supervisors (CEBS) had mandated that such institutions be in place for 36 selected cross-border institutions in the EU – where this has not already been done – by the end of this year.

⁷ According to a current survey by the SIG, this figure ranges from two to seven supervisors per core college.

regular exchange of experience on the various colleges at CEBS level for quality control purposes. The amended version of the Banking Directive,⁸ moreover, gives representatives of the CEBS secretariat the right to attend college meetings and gives this committee a mediating role where necessary.

Involving the supervised group is a sensible idea

In order to obtain a better idea of a banking group, it also makes sense for representatives of the supervised group to occasionally attend meetings of their responsible college. In practice, therefore, the procedure is generally twofold. Having group representatives attend the general college creates an efficient and coordinated communication process between the bank and its supervisors. Their attendance in the core college opens the door to an in-depth discussion of specific topics.

How the colleges work

Central guiding motives

The central guiding motive underlying the organisation of the working processes in the supervisory colleges – especially within the EU – is that decision-making should be as joint as possible based on avoiding duplication of work; this is so that supervisors can better assess group-wide risk. National restrictions governing the delegation of tasks, which are also recognised by CEBS in its relevant guidelines,⁹ represent the limits of this rationale.

Organisational responsibilities

In principle, the consolidating supervisor is responsible for how the college is organised. He initiates the supervisory conferences, coordinates the agenda and draws up the pro-

gramme of work, which must be updated at least annually. Moreover, he coordinates the flow of information, thereby fulfilling the role of a “central information clearinghouse”. As regards the distribution of information, there are typically two recognised criteria for relevance: relevance to the local market and relevance to the group. The consolidating supervisor is also responsible for the continuous quality control of the college’s activities, which may require adjusting the organisational structure to cope with new situations.

In their practical work, supervisory colleges use a variety of mutually complementary communication channels. They centre on actual physical meetings of supervisors, which may last up to several days. If required on short notice, videoconferences or teleconferences can be held. Secured web-based platforms are increasingly being established by the consolidating supervisors for the regular exchange of information.

Using all sorts of communication channels

Key aspects of the colleges’ work

The topics and content of the colleges’ work are the responsibility of the supervisory authorities involved. The content of the supervisory discussion and exchange of information revolve mainly around information on major risk areas and results of individual risk assessments by the supervisory authorities in-

The main content is fundamentally the responsibility of the supervisors ...

⁸ Published in the Official Journal of the European Union on 17 November 2009, it entered into force on 7 December 2009.

⁹ See CEBS, Guidelines for Delegation of Tasks Between Competent Authorities, CEBS 2008 193, September 2008.

involved, developments in the markets that are of relevance to the supervised group, an introduction to the group's financial situation, information on key transactions within the group (dividends and capital measures), issues regarding governance, risk management and internal controls, the results of examinations and inspections, reports and letters by individual authorities on issues of material relevance, important supervisory decisions that have been either taken or are pending, and key structural and organisational changes in the group.

... yet legally enshrined EU rules regarding content

Relatively specific rules governing the main content of the activities of supervisory colleges are already contained in Articles 42a, 129, 131, 131a and 132 of the Banking Directive. In addition, there exist general, non-binding basic principles – especially the 10 common principles for the functioning of supervisory colleges¹⁰ adopted jointly by CEBS, the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) and the Interim Working Committee on Financial Conglomerates (IWCF, now known as the Joint Committee on Financial Conglomerates (JCFC)) – and the content of the written cooperation agreements for each college.

Validation of internal models as main element of joint examinations

An additional focal point of cooperation within the supervisory colleges, alongside the aforementioned main content, is the planning and coordination of joint on-site supervisory examinations.¹¹ One key element of this cooperation is in the validation of internal models to calculate regulatory capital requirements. Article 129 (2) of the Banking Direct-

ive requires a joint decision by the supervisory authorities involved on the application of advanced measurement approaches for regulatory capital requirements. This includes drafting a time schedule for on-site examinations, conducting the examinations themselves and – where necessary – follow-up examinations to monitor compliance with regulatory requirements or to review the rectification of deficiencies. Depending on the type and the features of the model, the institution's organisational structure, its internal control mechanisms and the supervisory approach, decisions on the delegation of tasks are taken on a case-by-case basis while maintaining supervisory responsibilities. This serves to achieve not only a common understanding of supervisory criteria for examining models (methodology and documentation, data quality, quantitative and qualitative processes, technical environment) but also agreement on instruments of supervisory examinations and inspections. A common decision should be reached within six months and set down in writing. If a decision is not reached after six months, the ultimate decision at group level rests with the consolidating supervisor.

Another focal point in the off-site supervision of banking groups is cooperation in the implementation of the Supervisory Review and Evaluation Process (SREP) of Pillar 2 of Basel II. At the centre of the SREP is the supervisors' risk assessment of the affected group of insti-

SREP/CAAP at the centre of off-site supervision

¹⁰ See CEBS/CEIOPS/IWCF, College of Supervisors – 10 Common Principles, CEIOPS-SEC– 54/08/CEBS 2008 124/IWCF 08 32, 27 January 2009. The principles apply not only to banking groups but also to groups of insurers and financial conglomerates.

¹¹ Op cit, Principle 9.

tutions – including their view of the banks' Internal Capital Adequacy Assessment Process (ICAAP) to ensure their risk-bearing capacity – as well as supervisory planning. The aim is to ensure adequate management and coverage of risks within the risk assessment. In the college of supervisors, agreement is to be reached, in particular, on common or comparable benchmarks for ICAAP information to ensure consistency and comparability. For the purposes of practical activities, the consolidated supervisor is responsible for, among other things, planning the time schedule for the arrival of ICAAP information, monitoring of progress and, as appropriate, initiating follow-up work with respect to the banking group.

*Joint decision
on capital
adequacy*

The amendment to the Banking Directive introduced a joint decision on the adequacy of regulatory own funds pursuant to Article 129 (3). If the supervisory authorities represented in the college – even after consultation with CEBS – fail to achieve such a joint decision after four months, the decision is taken at group level by the consolidating supervisor and at the level of the subsidiaries by their competent supervisors. Alternately, the subsidiaries' risk assessments and the opinions and reservations of the consolidating supervisor should be taken into account.

*Processes and
formats of
supervisory
assessment*

National supervisors are fundamentally free and flexible in how they develop the processes and formats of these supervisory assessments. When creating prudential risk profiles, German supervisors take special care to recognise qualitative aspects and assessments; they by no means reduce the process

to a simply quantitative rating procedure. By specifically weighing and assessing banks' specific situations, this approach ensures that due regard is given, wherever possible, to the variegated aspects of the individual institutions. Principles-oriented classification criteria ensure the coherence of assessments using a classification grid without hampering the process and mechanistically pre-empting the findings.

In principle, all instruments for obtaining prudential information enter into the creation of the risk profile. This comprises findings from supervisors' examinations and inspections and also from off-site supervision (regular reports, extended disclosure requirements, cross-institutional requests for information and interviews with members of management and at working level). The aim and mandate of the consolidating supervisor in the supervisory colleges is, in the context of this exchange of information, to integrate this information – which may come in different formats – into the supervisory assessment of the group and to achieve a joint decision on this information in the college.

Instruments

There are currently efforts at CEBS level to promote the development of a common understanding of supervisory risk assessment in the college of supervisors. However, the national systems for risk assessment are to be retained.

*Pressure to
harmonise
supervisory risk
assessment*

The jointly developed risk assessment forms the basis for the joint supervisory planning, which is discussed and agreed in the college. At the centre of supervisory planning is the

*Joint super-
visory planning*

drafting of the normally annual time schedule, which incorporates proposals by the responsible supervisory authorities. The planning comprises joint activities or a definition of the division of tasks for group-level activities (including the obtaining of information). The planning of the various home and, as appropriate, host supervisors, which is based on the respective national assessments, represents a major input for judging the relevance at group level and, at the same time, influences the choice of instruments. The primary instruments are various types of examinations and inspections of banking operations (of individual business lines as well as of models) as well as off-site supervision instruments (such as interviews with senior management or requests for information).

Maintaining confidentiality

Maintaining confidentiality is a basic precondition

For practical work in the college, which is intended to ensure a continuous exchange of information between national supervisory authorities within the meaning of a cooperative and functioning network of supervisors, maintaining confidentiality is a basic precondition. In the EU, Articles 44 to 52 of the Banking Directive govern fundamental aspects of confidentiality with regard to the parties addressed and to the handling of information. In addition, these articles also include a liberalisation clause for non-EU supervisors: such supervisors are included in the exchange of information and, upon invitation by the consolidating supervisor, are entitled to participate in the college if confidentiality can be ensured at a level comparable to that of the EU.

Formal written coordination and cooperation agreements between the college members are an integral part for the establishment of a relationship based on mutual trust. They set the framework for cooperation and provide specific conditions and procedures for the exchange of information among supervisory colleges at various levels, reflecting the size, structure and complexity of the banking group. However, they should not be overly regimented, thereby hampering the effective flow of information: the defining feature of colleges of supervisors is precisely their ability to adapt to the structures and conditions of the supervised banking group. CEBS has already prepared a standardised form¹² for use in the EU, the details of which can be adapted to the group's individual needs. The coordination and cooperation agreements thus reflect not only the individual features of the supervised banking groups but also the quite manifold supervisory approaches applied by the participating supervisory authorities. To that extent, there is no "one-size-fits-all" approach to supervisory colleges: each college is specific to its supervised institution.¹³

Based on mutual cooperation agreements

¹² CEBS, Template for a Multilateral Cooperation and Coordination Agreement on the Supervision of XY Group, 27 December 2007; rewritten on 27 January 2009. One of the aims of the above-mentioned process of establishing colleges of supervisors for all cross-border banking groups in the EU is for such agreements to be signed by all participating supervisory authorities by the end of 2009.

¹³ This is also consistent with the SIG's vision that supervisory colleges be flexible bodies that can adapt readily to the needs of the home supervisor and the group's organisational structure. CEBS is also thinking in the same direction. See CEBS, Range of practices on supervisory colleges and home-host cooperation, 27 December 2007.

New challenges facing the work of the colleges of supervisors

Role of supervisory colleges stronger as a lesson of the crisis

One of the lessons from the financial crisis is that the colleges of supervisors are to be given a greater role not only in microprudential supervision but also as an instrument to improve the link between microprudential and macroprudential supervision. With this in mind, the G20, upon the re-inception of the Financial Stability Board (FSB) in April 2009, issued a mandate to adopt guidelines for the establishment and working procedures of international supervisory colleges.¹⁴ Now that the Basel Committee and the FSB have completed their joint stocktake of the design and functioning of supervisory colleges, the adoption of a number of principles and “good practices” for work in the colleges is scheduled for the first quarter of 2010.¹⁵ These principles are intended to cover structural and procedural issues and communication practices and state the role of the colleges in crisis management.

Establishment, consolidation and intensification at EU level, too: CEBS guidelines

At the EU level, the amended CRD is intended to increase the number of colleges of supervisors and to consolidate and intensify their practical work through the guidelines currently under consultation. The inserted Article 131a(2) of the Banking Directive gave CEBS a mandate to develop guidelines for the practical functioning of the colleges of supervisors. With the college guidelines recently put forward for public consultations, CEBS has provided such a general foundation for the work of the colleges of supervisors for banks. Its key elements include the exchange of information, opinions and assessments,

the delegation of tasks and activities, the development of a joint understanding of the supervised group’s and group members’ risk profile, the inclusion of macroprudential risks, reaching a joint decision on the validation of internal models for calculating regulatory capital requirements, the drafting of examination and inspection schedules based on the risk assessment, the coordination of prudential activities under Pillar 2 and the coordination of measures in an emergency case. The preparatory work was also accompanied by an inventory taken as part of a peer-review analysis of individual colleges of supervisors. In the context of a new “comply or explain” procedure introduced against the background of the planned convergence of supervisory instruments and procedures in the EU, CEBS can put pressure on national supervisors to implement the framework. This could consequently increase the need to eliminate any inefficiencies in working procedures by delegating tasks and responsibilities within the supervisory colleges. What is important here is that – in line with the underlying principles essential to understanding what colleges of supervisors are about – such voluntary delegations of tasks always be conducted in the light of the needs and the situation of the supervised banking groups.

In the light of the desire for a standardisation of sorts, these initiatives are to be welcomed. Such guidelines can be meaningful, especially

Coherence of different initiatives is key element

¹⁴ See London Summit – Leaders’ Statement. Declaration on strengthening the financial system – London Summit, 2 April 2009.

¹⁵ Although such guidelines are not legally binding, their rules governing the function and content of supervisory colleges still have the desired effects.

CEBS guidelines on colleges of supervisors presented for public consultation

At its meeting on 3 December 2009 CEBS put forward for public consultation a set of operational guidelines relating to the activities of supervisory colleges. These guidelines provide guidance for the tasks of the supervisors involved in supervisory colleges.

Chapter 1 provides guidelines to achieve convergence in the setting-up, formats, membership and governance of supervisory colleges, which are to be established under the auspices of the consolidating supervisor, or of the home supervisor in case colleges are established for entities that operate in other Member States by means of significant branches.

Chapter 2 contains guidelines on information exchange within the colleges, the timeliness of information and promotion of the use of the full suite of available communication channels. It also provides guidelines for communication with the supervised group and defines the participation of the group in the meetings of the college.

Chapter 3 focuses on the voluntary sharing and/or delegation that can take place within a college, except in cases where a joint decision is prescribed by European legislation. It is incumbent on colleges of supervisors to facilitate the voluntary sharing and delegation of tasks as this mechanism can increase the effectiveness and efficiency of supervision by optimising supervisory resources and expertise, avoiding the

duplication of tasks and removing burdens for the supervised institution.

Chapter 4 deals with the cooperative framework for reaching a joint decision on the supervisory approval and ongoing review of internal models.

Chapter 5 features guidelines on reaching a joint decision concerning the adequacy of own funds held by the group with respect to its risk profile and the required levels of own funds to be kept under Pillar 2 at the consolidated level and at the level of each entity.

Chapter 6 provides guidance and advice on how to take into account macroprudential and sectoral developments within the work of the college and looks in particular at the risk assessment of the group and its entities.

Chapter 7 explains how to establish a co-ordinated supervisory planning framework for going concern operations which includes both on-site and off-site supervision, so as to achieve a consistent group-wide approach to supervisory work while avoiding duplication of work.

Finally, chapter 8 outlines how to plan and coordinate supervisory activities when emergency situations arise in order to improve communication and cooperation among supervisors and with other authorities (eg central banks and finance ministries) during times of crisis.

when it comes to assessing existing similarities – such as similar problem areas or shared experience and lessons. However, it is advisable not to adopt excessively strict guidelines for supervisory colleges that would create uniformity, as this would pose the threat of impairing the efficiency of supervision. In addition, it would appear beneficial for the results of the various initiatives to be as coherent as possible.

Challenge: to integrate colleges of supervisors within the planned EU financial supervisory architecture

The system of colleges of supervisors, based on the idea of the consolidating supervisor, is an efficient and unbureaucratic system which serves as the centrepiece of off-site cross-border supervision of institutions active throughout the EU. A challenge to this framework will be in integrating it into the structure of the compromise to form an EU finan-

cial supervisory architecture adopted by ECOFIN on 2 December 2009 on the basis of the Larosière Report.¹⁶ In order to maintain the function of colleges of supervisors as a linchpin of cooperation in microprudential supervision, the role of the consolidating supervisor should not be called into question. Within the macroprudential supervision framework and the interaction with the planned “European Systemic Risk Board”, colleges of supervisors can make important contributions to macroprudential analysis. The information from the supervisory colleges and thus from the supervised banking groups, however, is often very highly sensitive; its protection must therefore be especially assured.

¹⁶ Report by the High-Level Group on Financial Supervision in the EU chaired by Jacques de Larosière, Brussels, 25 February 2009.