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KEYNOTE ADDRESS

Introduction

First of all I want to thank BBA and its Chairman Sir Peter Middleton for this opportunity to speak here today. CEBS and BBA are facing each other, not only on many challenges banks are currently but also on more concrete level: Few days ago the CEBS Secretariat moved to new premises in the City and we just realised that we are next door neighbours to the BBA. But I hope I was not invited here today just to keep good contacts with a new neighbour.

Before going into details of my speech I would also like to thank John Tiner for his kind words on CEBS in his speech this morning and his support for our work. I am not exaggerating when I say that the FSA has really helped put CEBS on the map. It organised our new offices in the City, housed our secretariat in the transition phase, and contributed together with other members to support the Secretariat with seconded staff.

The strong commitment of CEBS members, the old as well as the new Member States is the main factor keeping up the chances that we will meet the high expectations we face.

The fact is that we - with the FSA and other members of CEBS - have set aside a great deal of time in our first year of work in making sure we focus on the Capital Requirements Directive. We all believe it is our key priority at the moment. I believe that the successful implementation of Basel II is critical for the banking sector as well as for us as supervisors.

CEBS – a new European Committee

But, before I go into the detail of Basel II and other works streams of CEBS, I would like to say a few general words about CEBS.

CEBS is facing a number of challenges in implementing Basel II framework and supporting greater convergence of supervisory practices within the EU. One of the key tasks of CEBS is to enhance co-operation and information exchange between supervisory authorities. This is needed to ensure effective and efficient supervision of cross-border banking groups in an increasingly integrated market and ensure a level playing field for the banking industry. There are a lot of expectations around these issues and I'll touch upon them in detail shortly.

But talking about CEBS itself for a moment. As I hope you all are aware, CEBS was formally established less than a year ago in January. The Committee brings together senior representatives of the banking supervisory authorities and central banks of all European

Union member states. With 25 Member States, different legal systems and different approaches to regulation and supervision, there is clearly scope for divergence in the application of directives and in day-to-day supervisory practices and that's exactly why CEBS work is essential.

The Secretariat of the Committee started its work in London just a month ago and as I mentioned the Secretariat moved from the floors of the FSA to its new office in the City just a couple of days ago. But even before getting together the Secretariat worked in virtual composition. Right from the beginning CEBS has had its hand full of work.

We have been in constant dialogue with market participants and have already published three consultation papers, received responses and published them on the website www.cebs.org – which I urge you to use in order to keep track of our work.

The Secretariat is carrying now out all the necessary preparations, co-ordination and support for the Committee to work effectively and produce results in implementing new legislation on regulatory matters in the banking field and convergence of supervisory practice.

In order to promote a more consistent and convergent approach within this legal context, the members of CEBS will work together to develop guidelines, standards and recommendations, which can then be implemented into national practices and ensure a more homogeneous regulatory and supervisory framework within the Single Market.

Pillar two

I hope you have visited our website and have seen the state of our ongoing process of consultations and especially our third paper on supervisory review and responses to it.

Now that we have the final Basel Accord and the published draft of the Directive I am very conscious that this audience is interested to know how we think the Capital Directive will operate in practice. The importance that my committee attaches to this particular issue was shown by the release of our Consultation Paper on "The application of the supervisory review process under pillar 2", which was published in May.

This did not appear overnight. Our Consultation Paper was developed over several years, during which EU supervisors talked to their national industries to get a clear understanding of what banks and investment firms wanted. And of course we have studied the major submission EU Associations made to the European Commission on Pillar 2 last year [October 2003]. Although the Directive text is still under Discussion, we decided to release this consultative Paper because we considered it important to consult interested parties at an early stage in order to encourage dialogue and to promote transparency in the debate between supervisors and financial institutions on this decisive issue.

The BBA, together with LIBA and ISDA, have now given a profound response to our Consultation Paper and I must thank you for that. The process is still ongoing and we are preparing a summary of the responses in due course.

CEBS is working hard on the development of common principles for the implementation of the supervisory review process. We are aware of the industry's desire to see EU-wide implementation of this important piece of the supervisory framework. Our intention is to get the consistent approach that you the industry, and we the regulators, both seek.

Our Consultation Paper sets out principles for the overall Supervisory Review Process and its two main complementary elements: the Internal Capital Adequacy Assessment Process – the firms' evaluation of their capital needs - and the Supervisory Review and Evaluation Process – the supervisors' process to evaluate firms. The paper describes in high level principles what supervisors will expect from institutions in their assessment of the adequacy of their financial resources. It also contains principles on the supervisory authority's obligations under Supervisory Review and how these might be performed.

I am pleased to see that we all agree that the Capital Adequacy Assessment Process should be owned by the financial institution itself. And that it is for the institution to define, develop, and manage its Process. The banking industry – like we at CEBS – support the concept of proportionality. The principles are also intended to enhance the level playing field in the EU under the new capital regime. Rest assured that we will stress again and again that the concept of proportionality should play a key role in both the Internal Capital Adequacy Assessment Process and the Supervisory Review and Evaluation Process.

I also think we all want to see a risk-based framework. We have made clear that it is the responsibility of the institution to define and develop its Assessment Process, and that this assessment should be risk based.

All of us agree on the importance of capital planning. The new Basel framework emphasised the importance of capital planning but also the importance of management responsibility and other qualitative aspects of risk management.

So far so good. We are moving rapidly to agreement on the key issues. But I also want to flag up today to a number of areas where we have not fully converged with your thinking. I must emphasise that these are my initial reactions. But I think it is my responsibility to let you know as soon as possible where we might not agree.

I am conscious that large parts of the industry have argued that the whole Supervisory Review Process should be driven by the institution and should be responsibility of the firm management and should be integral to the management of the firm. That is not exactly how we see the Process. On reflection I hope you will agree that this view would lead to a pretty unbalanced Process.

Our consultation paper recognises that the firms' process and the supervisory review are separate processes. The first is yours and the second is ours. You and we will use them for a variety of purposes. But we are also proposing that the two processes should work within a wider Supervisory Review Process. That means in practice they are closely intertwined and that there will be a close interaction between them. This interaction will generate an important and necessary dialogue and feedback mechanism. You and we will both benefit

from this. I want to give you some key words that we intend to bring to Supervisory Review: *dialogue, partnership and interaction.*

The Pillar I capital requirements will continue to be seen as a minimum for regulatory capital requirement based on uniform rules. As part of the supervisory review process, regulatory capital over and above Pillar I is seen as one of several regulatory and supervisory tools to be potentially used by the supervisors to mitigate identified risks, having carefully considered controls and other mitigating factors.

Having given you the first tranche of our thinking on Pillar 2, we are now turning our attention to analysing the good number of responses we have received. You can read these for yourself on our website. And of course we will respond formally in due course on the full range of issues you and others have raised. The plan at the moment is that CEBS will publish a full compendium of standards or principles based on our work on Pillar 2, which could act as a guide book for the industry and for supervisors.

I should tell you that even while we are doing this analysis we are also aiming to move faster with our work. We are digging deeper to flesh out Pillar 2 and to see how the central dialogue between the internal process and supervisory review will operate. I want to know how they will interact to achieve an effectively functioning Supervisory Review Process. We are also working on principles for the internal governance of risk management under Pillar 2.

And of course we are also trying to work out what implications the new Capital Directive will have on home/host issues. I should just say - on this last point on Capital Directive's implications for the EU's Home-Host regime - that we are very mindful of the views of some in the industry. Some of you have argued quite forcefully for a one-stop-shop for supervision for large cross-border institutions. I truly believe that within the present institutional framework a more pragmatic approach is needed.

We all agree that there is a need for an efficient EU regime that does not impose unnecessary costs and burdens. But we must also be aware of legitimate statutory responsibilities and the need to protect consumers across all jurisdictions. I think we are shooting at the same rabbit, but from different angles. We can hit the target by dialogue, partnership and interaction.

Common EU reporting

One aspect of convergence of supervisory practices is streamlining the reporting of banks and credit institutions throughout EU.

It is a traditional request from the banking industry that we try to achieve a streamlined reporting regime for all institutions, especially for institutions with presences in several Member States. Institutions have always complained about the multiplicity of reporting requirements. I hear their argument that the necessity to draft as many reports as they have authorities involved in the supervision of their group, is very burdensome and time consuming.

Supervisors, for our part, are aware of the amount of work that the compliance with many and very different reporting requirements from several competent authorities can represent. But we are also conscious of the technical and legal difficulties of moving towards a more common reporting framework. We must not undermine our ability to be adequately informed about institutions for which we have supervisory responsibilities. We should be able to exploit fully the information available at local level, that is useful within the specific features of local markets.

We see the entry into force of the Capital Requirements Directive as an opportunity to try to address the industry's long standing concerns, while, at the same time, trying to reach a framework suitable for supervisors' needs to fulfil our statutory duties. I would note that the task of striking the right balance between institution's claims and supervisors' genuine right of being properly informed cannot, by any means, be considered as an easy task. But the good news is that CEBS is tackling this task, and good progress is expected within a very tight time frame.

The first step in the right direction is to reach a "common way" of reporting the Solvency Ratio, that while providing for a high degree of commonality, allows for some kind of flexibility, giving to each supervisor the (limited) possibility of requiring some specific information outside the common reporting. To achieve this CEBS is investigating technical solutions to enable common reporting on a platform by which different data streams could be processed.

We are now embarked in this challenging task and I hope that I will be able to give you some news in this respect in the near future.

National Discretions

Let me finally touch on another topic where CEBS is making progress. I fear some critics might say too little, too late. I'm now talking about the national discretions in the Capital Directive.

The European Commission's draft Directive currently contains a large number of regulatory options left open to national discretion. Some of these discretions are to be exercised by banks and investment firms. They reflect the flexibility needed by financial institutions to assess their risks and the related capital adequacy, and allow them to select these options which are most appropriate for their business. I would assume that you are not expecting a reduction in the number of these discretions.

However, a substantial part of the national discretions (around 100) provides Member States and the supervisor authorities with the opportunity to choose between two (or more) possible approaches, and to ask institutions licensed in their jurisdiction to comply with one of them. We see the point that an uncoordinated use of these national discretions has the potential to hamper the smooth development of cross-border business in the Single Market. On the other hand it needs to be acknowledged that some national discretions are necessary to

adapt the new capital adequacy framework to specific features of national markets and to local business practices.

Against this background, the Chair of the Banking Advisory Committee (BAC) asked CEBS to perform a stock-take to identify how these options are likely to be exercised in the different jurisdictions and whether they were perceived as indispensable from a supervisory point of view. It was also noted that this analysis could then form the basis for a proposal to the Commission as to which discretions might be removed from the draft Directive.

Actually a certain number of national discretions have already been removed from the Directive and CEBS is proposing to remove more. These deletions should prevent diverging implementation of the directive.

It is also worth mentioning that around 80% of the discretions we have identified are contained in the Annexes of the Directive. This suggests that they can be amended swiftly via comitology procedure, i.e. by the Commission in cooperation with the European Banking Committee (level 2). The Commission could therefore formally mandate CEBS to continue its work on national discretions with a view to provide advice on the ways for their further reduction.

I think we all wanted to be bold and to achieve a great deal from this work. Market participants favour a regulatory framework with little or no space for national options – and I have to admit that I also hoped that we could make more progress in this field, even in such a tight time frame. But we all have to realise that achieving consensus on such delicate matters requires enormous effort in a setting with 25 Member States.

With time and a great deal of political will and determination we might be able to go far. But to get the best results we need help and support. You, the banking industry, could also help us in this work by making your priorities clear. I am quite certain that you can find areas of the single market where flexibility is not needed any more.

Conclusion

I would like to take this opportunity to stress once more the importance of transparency and dialogue as we enter the new phase of Basel II. CEBS has a vocation to be as transparent as possible. The whole thrust of the Lamfalussy framework is based on the belief that close technical dialogue between competent authorities and open consultation with interested parties will lead to better quality regulation.

I hope you will take full advantage of our website (www.c-ebs.org), and follow our consultation processes and responses published on the website. You have given us your views on the latest consultation paper, but this process will continue. And we want to hear your views. Your active participation in the debate is key for the success of our endeavour.

Thank you for your attention.