

ZENTRALER KREDITAUSSCHUSS

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Dr. Mie/Me 090409 de Larosiere report (english) ZKA

Comments of Zentraler Kreditausschuss on the EU Commission's Consultation concerning the "de Larosière -Report" dated 25 February 2009 and on the Commission's Communication Paper "Driving European Recovery" dated 4 March 2009¹

Dear Sir or Madam,

In view of the presented deliberations concerning a reform of the provisions on financial market supervision, we appreciate the opportunity to comment on the aforementioned documents and would like to submit the following, more detailed comments.

I. Preliminary remarks

The current financial turmoil crisis and the associated profound implications are not over yet. Hence, the ongoing efforts aimed at preferably short-term measures for overcoming manifest shortcomings of financial market regulation that seek to end the financial market crisis are understandable. Based on the foregoing, we also understand the EU Commission's plans expressed in its document published on 4 March 2009 to possibly abridge the de Larosière group's timeframe of up to three years since this is perceived as too long. In its Communication for the Spring European Council the EU Commission expresses plans for kick starting the implementation processes for resolution of the latter issues by the end of 2009 (max.). In view of the wide variety of issues concerned and the sometimes extremely complex queries at stake, this timeline appears highly ambitious. The corresponding works are extremely important. We therefore strongly advocate in favor of quality before speed. Hence we particularly welcome the EU Commission's announcement that it wants to implement the reform of the European financial system (which itself perceives as ambitious) on the basis of impact studies and under due

¹ The comments are subject to approval by the bodies of the senders.

consideration of the self-imposed principles of “better regulation”. EU Commission compliance with these self-imposed goals will prevent a proliferation of meaningless regulatory processes that might delay the eradication of regulatory shortcomings.

In our understanding when creating new regulatory approaches, it is equally important to possibly adopt a worldwide concerted action that reaches beyond the European regulatory arena. More specifically, the work at a European level and the Basel Committee for Banking Supervision’s activities frequently take place simultaneously; at this juncture a closer coordination would appear helpful and desirable. Hence, in terms of content, we fully agree with the view expressed by the EU Commission under Annex I (page 3, 5th bullet point) that a corresponding need for international coordination and coherence in the upcoming work is indispensable. This aspect should definitely be taken into account in all relevant fields.

II. Specific Comments

1. Financial Market Supervision Architecture

We particularly welcome the proposals made by the de Larosière Group and endorsed by the EU Commission, i.e. better dovetailing of macro- and micro-prudential supervision. One of the weaknesses highlighted by the financial market turmoil was the fact that there was a failure to recognise in a timely manner the impact which the macroeconomic risks would have on individual system relevant companies and/or the failure to adopt sufficient measures as far as the micro-prudential supervision strategy was concerned.

Based on the foregoing, it is correct that the central banks are given a mandate to assess “high-level macro-financial risks” and to issue warnings (indent 174 of the de Larosière document). The establishment of a European Systemic Risk Council (ESRC), too, may make an important contribution towards better supervision of macro-prudential risks (indent 177 de Larosière document). We are strongly supportive of the case-by-case approach of a wider involvement of supervisors other than central bank supervisors, i.e. also insurance and security supervisors (indent 179 de Larosière document).

However, there should be a critical review concerning if and how the mere foundation of a new body with high-ranking officials may lead to better dovetailing of macro- and microprudential supervision. It is not about transporting certain information into an apex body which is then to decide on warnings or measures. The identification of relevant macro-risks and adequate supervisory strategies is a complex process. Apart from the foregoing, this exercise requires in-depth cooperation between central banks and supervisory authorities at many levels. Hence, also at the level of senior management, there should be a close exchange. Therefore, we would welcome a joint, high-ranking liaison group between ESRC and the financial sector, which ought to be similar to the Consultative Panel for the 3L3 Committees where issues of financial market stability could be discussed on a regular basis. In the final analysis, it is not primarily about the creation of a new body but rather about better dovetailing of existing functions which – to date – still suffer from suboptimal interfaces.

Also in the run-up to the financial market crisis, there was no paucity of warnings. Yet, the identification of macro-risks must also lead to adequate supervisory action. In our view, the mandatory follow-up envisaged under recommendation 17 of the de Larosière - report therefore appears to be indispensable. Also here, the “comply or explain“ procedure now used in the EU’s Level 3 Committees should be applied. Such a mandatory accountability obligation would help supervisors galvanize internal and external support for requisite measures. However, at any rate, in order to safeguard adequate functioning of the structure, the cooperation policy between ESRC and national supervisors still requires a more differentiated approach.

The financial crisis has furthermore shown the strong global links between the real and financial economy. The proposals of the EU Commission and the de Larosière group are, quite necessarily, focused on the EU level. Yet, solutions need to be of a global nature or, moreover, need to fit in with a global prudential supervision architecture. Therefore, the recommendation of not limiting European solutions to the Eurozone (indent 173 of the de Larosière document) should be fully supported. Furthermore, the EU should try to insert its work into a global context. This not only relates to the risks emanating from non-European markets but also to the measures which need to be adopted by non-EU supervisory authorities. In this regard, we would like to reiterate the foregoing presentations in the preliminary remarks which shall apply accordingly.

In order to prevent multiple reporting requirements, the institutions represented on the ERSC should forward information received at a national level to ERSC. At the same time, ERSC should satisfy their own potential information need only via the by it represented supervisors. This approach offers a decisive advantage, i.e. banks only have to interface with one point of contact which helps to prevent unnecessary duplication of work and may potentially also avoid ambiguity with regard to the requested information.

2. Changes to the supervisory framework

From a supervisory point of view, contrary to the past, there needs to be a stronger recognition of existing mutual dependencies in the financial markets. This requires a comprehensive supervision over the entire financial sector i.e. it shall not only be limited to banks, insurance firms and capital investment firms. Particularly the so-called shadow banking system requires future regulation which adequately takes account of the risks emanating from the relevant market participants. In this context, however, the principle „same business, same rules“ equally requires consistent application. Without an adequate assessment of possible risks and potential trends that might distort competition, one should especially refrain from incorporating into supervisory rules and regulations the recently proposed plans for a light regime (e.g. e-Money transactions, micro credits etc.) concerning certain market participants. Based on the foregoing, we welcome the EU Commission's announcements that it will be presenting appropriate proposals on this matter by the end of April.

First of all we would like to reiterate our aforementioned view that especially the activities at EU level should be closely dovetailed with the parallel works at the Basel Committee for Banking Supervision. This is especially true with regard to the work announced by the EU Commission concerning the quality and quantity of equity as well as the reduction of

procyclical effects resulting from regulation. One further point in case is the fact that during the drafting process for the Basel II regime, especially the issue of procyclicality has already been the subject of intense debate on the part of supervisors. The expertise accumulated in this context by the Basel Committee for Banking Supervision should definitely also be used for potential regulatory measures at the European level. In view of the pivotal importance which equity has for market participants, we strongly advocate in favour of a solution where the work announced by the EU Commission aimed at preparing a respective report on the issue of procyclicality by the end of this year should be as transparent as possible; there should also be adequate involvement of the various economic stakeholders into the opinion building process.

We object to the introduction of a more comprehensive ratio which should be easy to establish and which was announced by the EU Commission (back stop regime); in addition to the risk based requirements under the CRD, said ratio is supposed to be a complementary ratio. From our point of view, such a ratio dilutes the risk based view of the current prudential supervision provisions which, in our understanding, are basically correct. Nor is it suitable as a means for limiting procyclical effects and it does not help to avoid excessive balance sheet expansions, either. The US case has shown that developments that are akin to a crisis could be neither prevented nor mitigated by such a ratio - even in those cases where this procedure had been installed a long time ago. Quite on the contrary, the current crisis was created in the US which is where it has also given rise to the biggest damage. Plans for adopting a regulatory approach which - during its practical application - has already demonstrated that it fails to prevent crisis-prone trends are rather unconvincing. The point of departure for each and any suitable regime for the future prevention of crisis-prone trends needs to consist in an exact identification of the shortcomings in the current supervisory regime. Already today, the respective shortcomings in the regulatory framework of the CRD can be addressed through Pillar II. Hence, there is no need for an additional instrument by way of introducing a corresponding simple risk ratio.

3. Treatment of complex financial products

We fundamentally support the endeavors of the EU Commission and of the de Larosière group, i.e. reinvigorating confidence into the derivatives markets. However, all of the initiatives' impacts need to be thoroughly analyzed in advance at this juncture. Whilst for many derivatives simplification and standardization may lead to improved understanding and simplification of the risk management, the option of market innovation and bilaterally agreed terms needs to remain available. As far as transparency is concerned, there should be a clear specification as to the kind of different types that shall be affected (transparency concerning the properties of the instrument, price transparency, market transparency). Furthermore, attainment of each of these types of transparency comes at its own price. For instance, the potentially negative implications for market liquidity ought to be considered.

On principle, the Code of Conduct was developed in order to facilitate more competition in stock markets at the level of the central counterparty (CCP) and central securities depository (CSD). There already exists strong competition on the market for OTC derivatives, meaning that here, the point of departure is different. However, in view of the establishment of CCPs in OTC derivative markets which seems to be taking place, an

expansion of the rules and regulations of the Code (for instance with regard to interoperability) may appear helpful in this regard. At this juncture, it would be helpful to wait for further experience with the Code in stock markets. At the same time, the expansion of the scope of the Code of Conduct to include derivatives is already being discussed in the EU Commission's CESAME II working group.

In this context we also back the initiative for the introduction of a central clearing unit for credit derivatives within the European Union. The goal must be the establishment of competitive, efficient and robust European structures. After all, also in future credit derivatives will remain a pivotal instrument for risk management. However, it should also be noted that not all CDS are eligible or, moreover, fit for purpose when it comes to CCP clearing. In this area, introducing central clearing for eligible credit derivatives can be seen as an important contribution towards the mitigation of systemic risks.

4. Supervisory monitoring of remuneration regimes

We subscribe to the EU Commission's view that the recommendations on the remuneration rules for executive board members of financial undertakings need to be adjusted in light of the experience gleaned in the context of the financial market turmoil. Yet, we do have doubts with regard to a comprehensive regime which should apply to all employees within the financial industry and where monitoring would have to be incumbent upon banking supervisors. Under the current proposals, banking supervisors are supposed to be granted certain sanctioning tools. From our point of view these powers are a cause for great concern since it is not clear if they are always compatible with national law. For instance, in the Federal Republic of Germany, collective bargaining is the sole prerogative of both sides of industry and has to be free from any outside interference. This right is even enshrined in Germany's Constitution. Hence, we feel that at this juncture, the scope of the individual regulatory areas needs to be carefully staked out and that the rights to interfere with certain processes need to comply with the principle of proportionality.

Yours sincerely,

For and on behalf


ZENTRALER KREDITAUSSCHUSS

Bundesverband der Deutschen
Volksbanken und Raiffeisenbanken e.V.

For



Gerhard Hofmann



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