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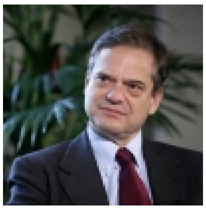
Forthcoming banking regulations: what potential impacts and issues for the EU banking sector?

Speakers



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European Banking Authority (EBA) , Chairperson

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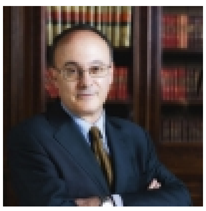

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ING Group , Chief Risk Officer and Member of the Executive Board

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The Goldman Sachs Group, Inc. , Managing Director, Global Co-Head -Office of Government Affairs

Objectives of the session

The session tried to assess the magnitude of the forthcoming global regulatory evolutions in the context of an already unprecedented regulatory overhaul initiated in the wake of the financial crisis. The rationale and the main consequences and issues related to these additional significant initiatives were also outlined.

Executive Summary

Basel IV: reducing risk weight variability

Many consultations were underway on issues such as changes to leverage ratio and operational risk. A 3% Basel global minimum for leverage ratio had been confirmed, although some countries had adopted a higher standard. Current challenges included specifying the capital baseline and ensuring that all regions reached it. Conversely, there were instances where regions had adopted more robust standards than the Basel minimum.

One critical intention was to reduce risk weighted asset variability. Some risk weights had been revealed to be unfathomably low, which proposals had been introduced to fix. The governors and heads of supervision had announced a yearend deadline for completion of reforms.

Indeed, Several CEOs in 2011 had said at the time that the recapitalisation exercise had been launched by the EBA, that they would comply by risk weighting optimisation, which everybody had read as tweaking the models to circumvent the requirement. The investors had been concerned seeing banks with similar portfolios coming out with very different calculations of risk weighted assets.

The EBA had since produced five reports to understand the issue, and Basel had also completed useful work. The industry understood that the issue needed to be addressed and they had to accept that a lot of those differences had been driven by supervisors applying different rules. They needed to repair those issues and provide clarity and consistency to the market.

A prominent issue arose from what was considered ‘significant’. In the finalisation of Basel IV the main restriction had been on not ‘significantly’ increasing capital requirements. However ‘not significantly increasing capital’ was a vague term. One way of viewing significantly increasing capital was its impact on outliers. Outliers were likely to have to increase their capital. A concern was that there were a number of outliers banks in the EU, which actually needed to have 20% more capital.

Housing Finance and Real Estate

A public authority representative noted that the issue that received the most attention regarding risk weighting was housing finance and real estate. It had been suggested that all housing and real estate markets were special. It was also highlighted that differences between markets were never as significant as people thought. Finally, the panellist from the industry concluded by saying that a number of distortions had been introduced by creating something floor based on the basis that those markets were the same.

Low default portfolios had been given high risk weight in the latest proposals. Though they could not ignore that low risk weights did not indicated that Probability of Defaults (PD) were low, but also reduced Loss Given Default (LGD). Indeed, they often had low default portfolios either because not many defaults happened or because the transactions that they did with those clients were self liquidating. The desire to be conservative was understood, but it was stated that the combination of the PD and LGD could not lead to the risk weights that they were seeing, which was a concern.

To move forward they had to look at the structure of those markets in greater depth. Indeed, European systems under Insolvency legislation featured personal liability and there were therefore fewer losses in those systems than in the US'. In addition, although one would have thought that large banks adding up to the majority of the population in a given country would have to have the same risk profile, however, their risk weights were very different.

The differences in the investor perceptions between the EU and US banking sectors might had to do with the different respective supervisory practices, which were also illustrated by the respective stress testing approaches that had happened.

Regulatory Uncertainty

Another important concern of bankers, investors and analysts was the regulatory uncertainty arising from decisions yet to be made, and reforms yet to be closed. It was becoming increasingly urgent to complete processes and move to a different stage.

The specific issues of regulatory uncertainty needed clarification. The calibration of already agreed requirements was an area with no uncertainty. However, there was uncertainty in the repair of internal models, and providing clarity and consistency in the application of completed reforms. Both areas required rapid regulatory responses.

If organisations needed more capital, they would endeavour to find it; however, the uncertainty was over the amount of capital that was required, which then needed to be communicated outwards.

Pillar II was an additional challenge due to fragmented application; however, there was commitment to eliminating differences. Resolving the issues in definitions would also reduce the difference in risk weighted asset calculations.

A Risk Weighted Approach to Banking Regulation

Further reduction in the differences of risk weighted asset calculations required improving the standard and internal models, and implementing the leverage ratio as a complement to capital requirements. Stress testing was also important.

Getting the capital level right had become less accurate in the current proposals. However, there were reasons to think that some portfolios could not be individually modelled. Input and output floors needed to be considered, and they also had to define how they implemented leverage ratio.

Models tended to be more effective in practice if used for both regulatory and business purposes. Consequently, the more regulators desensitised models for risk, the bigger the problem would become as whenever risk weights were defined according to a floor higher than the actual risk, the incentive to provide more careless lending would be there.

On the risk weighted approach towards banking regulation; first, they were not afraid of well capitalised banks releasing capital requirements. Second, it was concerning that the industry increasingly sought shortcuts to push for better capitalised banks rather than working on plain capital requirements based on risk weights.

There were also points that undermined the risk based approach. First was on incentives; if they insisted that risk weights were defined according to a floor higher than the actual risk, the incentive to provide more careless lending would have been there. Second was on complexity; they had many ways of accounting for capital requirements, which made some people uncomfortable. Third was that risk weights were not perfect.

There were some firm believers in stress testing and the virtues of the leverage ratio. However, Insolvency legislation was identified as a problem which made life different across jurisdictions.

One element of the 24 March proposals that had gained attention was the prospect of an output floor. Some thought that capital floors were a problem. If they wanted to calibrate their capital levels, it had to be done through a portfolio of floors.

Supervision

The framework for the prudential regulation of the banking sector was essentially a three legged stool with risk based metrics, leverage ratio and stress tests. There was a danger in the extent to which they were turning the risk based leg into a non risk based measure.

It would also be important to discuss the role of supervision. The Basel Committee had completed a lot of work which had seemed to be setting the stage for more intrusive work as supervisors. It was worth inserting that as a much more significant part of the Basel agenda. It was noted by some that they were moving back towards supervision, and that they also had to consider the importance of risk management governance culture in banks.

The work over the course of the year had largely been taking the risk based leg of the stool and turning it into a second non risk based leg. Further work in that area was recommended.

There was a critical role for supervision. The regulatory phase was concluding and they were seeing a clear move towards implementation and supervision.

Remaining Issues

On the lack of analyses of the cumulative effects of all measures completed by separate bodies, there was a discrepancy highlighted between the ambition levels of the organisations driving it, and the realities at the level of a real bank considering the consequences.

There was also uncertainty on who would reduce risk if the banking sector shifted them into the markets. There was also lingering uncertainty as to whether that would benefit taxpayers or if Europe was prepared to intervene and absorb some of the risks through the Central Bank balance sheet.

Package reforms had consistently strengthened the treatment of the trading book, reinforcing capital requirements, introducing a non risk weighted metric, and repairing the problems identified in the internal model.

Conclusion

Since the beginning of the crisis, the intention had been to make something coherent, but the results had not always been so. Directives were thought to no longer be the correct instruments for a 28-member union. They perhaps needed to make fewer regulations, but also had to reduce creativity in implementation at a national level.

Second, the importance of supervision was emphasised. They needed strong supervisors with tough powers.

Finally, the industry was advised to relax. They concluded that they had to believe that progress was possible and, although they wanted to keep the UK on board, they would carry on.

Detailed Summary

Regulatory Uncertainty regarding Risk Weighted Assets

A public authority speaker said that on risk weighting assets, several CEOs in 2011, at the time that the recapitalisation exercise had been launched by the EBA, had said that they would comply by risk weighting optimisation, which everybody had read as tweaking the models to circumvent the requirement. At that time there had been concern in the analyst world amongst investors. They had been seeing banks with similar portfolios coming out with very different calculations of risk weighted assets, which everybody had seen as a problem.

The EBA had since produced five reports to understand the issue. They now better understood the drivers of those differences. Basel had also completed useful work and so they were in the process of repairing the issue. A consultation had also revealed good feedback from the industry. The industry understood that the issue needed to be addressed and they had to accept that a lot of those differences had been driven by supervisors applying different rules. They needed to repair those issues and provide clarity and consistency to the market.

Since that experience, he was no longer sympathetic to the idea of floors, but understood that that came from the national debate.

Basel IV: reducing risk weight variability

A public authority speaker thought that it was important to explain how they had reached their current position and where they were going. In 2010 they had completed Basel III in record time, had set the broad contours for the framework, and had provided an implementation period to be fully phased in by 2019, which had given them a lot of lead in time to raise capital and meet the new standards.

At that time, they had also conducted a long term economic impact study. They knew with statistical certainty that there would be another financial crisis, but did not know what would trigger it, its magnitude, or when it would happen. He asked the panel to keep in mind that they were laying the long term groundwork for a safer and more resilient banking system.

A regulatory body spokesperson said that it was understandable, but unfortunate, that there was a short term view. He felt that rolling back adopted provisions would have been unfortunate, and that removing things that had been implemented would not change things overnight.

He noted that the governors and heads of supervision had announced in January that they would finish reforms by the year’s end. Those reforms were substantive; and they had proposed changes to the IRB credit risk and operational risk frameworks. He stated that the intention was not to raise capital significantly. Instead they were trying to reduce risk weight variability. He suggested that most of the banks present had probably participated in quantitative impact studies. He said that there were some unfathomably low risk weights, which they had introduced proposals to fix.

He outlined that they had opened the consultation for IRB credit risk and were also consulting on operational risk. They had proposed eliminating the use of models for operation risk and had also been consulting on changes to the leverage ratio. The governors and heads of supervision had confirmed a Basel 3% global minimum for the leverage ratio, although some countries had adopted a higher standard.

Furthermore, he said that they were currently consulting on the possibility of an additional surcharge for the leverage ratio, as they had on the risk weighted side.

A public authority representative outlined that they intended to end the revisions by the end of the year, were finalising Basel III, and had new capital, buffer, parameter and denominator definitions.

A regulatory body speaker outlined that on global aggregate data he saw a baseline of where they were with capital. Not significantly increasing that baseline was one way of looking at it on a global aggregate basis, however defined. There were regions in the world that were considerably below that baseline, but those were things that had to be resolved during the course of the year. They also had to work out their starting point. What the baseline was and whether it included the changes that they had made to the market risk framework that year were agenda items to be finished by the year’s end.

He continued that Basel created a minimum standard. All Basel requirements had minimum requirements, but based on national circumstances it was sometimes warranted to adopt a more robust standard than the Basel minimum. He reminded the panel that the Basel Committee had no authority or sanctioning power; they created global standards and it was up to each jurisdiction to adopt them, as agreed at the Basel table.

One speaker noted that there was an issue of timing. the speaker asked why it was urgent that they took a decision by the year's end. The speaker also identified that there was a question of legitimacy, and that one had to be able to explain where rules were coming from when they were adopting them. There was a preference between tailor made rules and a global level playing field, which was typically a political decision; but they all had to think about where that type of decision was taken.

Basel IV Impact: are EU Banks Outliers?

A speaker on behalf of a regulatory body stated that what was meant by 'not significantly increasing capital' depended on who was asked. His perspective was informed by global data whereby they observed the impact per bank on both a country and regional basis. He explained that one way of looking at not significantly increasing capital was the impact on outliers. He acknowledged that outliers were likely to have to increase their capital, but noted that that was what an outlier was by definition.

An industry representative was interested to know who did not feel like an outlier according to the calculations that they had made. In the past few days he had only met outliers that had told him how much their capital requirement had increased. He was looking for conventional outliers, as well as alternative outliers that had had a huge reduction. He said that there was an issue of adding up and bringing the evidence together.

Another industry representative could not believe that, as a large pan European bank with some non European activities, his own bank was an outlier. If they were then there were many others, which defeated the purpose of identifying outliers. His first observation was that, whatever the ambition, they had not fine tuned those iterations to a point of convergence on a goal that they could all align behind.

A banking representative agreed with much of what had been said. He confirmed that his organisation was also an outlier. They had used various calculations and found that they had an average of 25% risk weight in the mortgage business. Regardless of the calculation, they had always ended up needing something like 20% more capital. If everybody was an outlier, then they actually needed to have 20%more capital.

He stated that 20% was a high number for them, and if it was what they needed, then they needed to act immediately.

Significance of the Impact

A speaker identified that one issue that had come up was of significance of the impact of the projected regulations, which the speaker thought was a subjective concept that depended on whether it was appreciated by the person taking the decision or the person experimenting with the decision.

A regulatory body spokesperson stated that on the impact of the reforms and the finalisation of Basel IV, the main restriction they had was the decision not to increase capital requirements in a significant way. That raised two difficulties. The first was how they defined whether it was a significant increase; the second was how to measure such an increase. The first difficulty was very important, and needed to be addressed. The second point had to be measured with a group of banks with different business models, studying the quantitative impact on different models of different banks of different sizes, which would be difficult. The two areas were difficult, but crucial areas to address.

Regional and Domestic Housing Finance Risk Specificities

A public authority representative noted that the issue that received the most attention was housing finance and real estate. He had been told that all housing and real estate markets were special. He thought that there was no chance of a systemic collapse in housing markets. He noted that he was not advising others to calibrate to the tail of the risk curve, but he recognised that everyone was only special until they were not.

A regulatory body representative thought that in some jurisdictions, perhaps the US, the market had been designed to create large losses. He said that there would of course be large losses in a system where you could deliver a key in the mailbox and walk away. That differed from any European Insolvency legislation, where you could not walk away; there was personal liability and therefore very low losses in many of those systems.

He concluded that they were creating a number of distortions to create something floor based on the perception that those markets were the same. He felt that it would be difficult, but that if they looked at the structure of those markets in greater depth, there could have been a way forward to designing something.

A banking representative wanted to contribute to the point raised on the difference between Europe and the US. In terms of investor perceptions between their respective banking sectors, the difference was less with regard to the application of the rules because Europe had applied the Basel rules to a much broader set of banks than the US had. He suggested that it may have been to do with different perceptions regarding the supervisory practices in particular as they were expressed by the stress testing that had happened, relative to the European authorities. That was an element of what was driving some of the changes they saw.

An industry representative outlined that there was a European issue at a global level. He suggested that all housing crises looked different, but were similar. He added that the impacts differed. He stated that regulation could not be the same; but that was a European issue. If they copied what was done at the global level, they had to account for a certain amount of harmonisation on the basis of the rules, even though the impact was different. If they simply copied it because they were not regional enough to understand that although the rule was the same the impact was different, then the fault was their own. That had to be taken into account in all places where European legislation was produced; it was a fundamental difference that they could not escape. The Capital Markets Union would take years to build, and so would not be a short term solution to the problem.

A banking representative wanted to respond to what had been said about all markets being special.

He outlined that whenever they worked in new countries they were advised that the markets were entirely unique. The reality of the situation was that the differences were not as big as people made out.

However, that did not mean that portfolios carrying the same products for the same name were the same. When he had returned to the Netherlands five years ago, he had been surprised to see the difference in risk weights between the mortgage portfolios of the three big banks. Back then, they had shared 73% of the market. He said that one would have thought that three big samples adding up to the majority of the population would have to have been the same; however, the risk weights had been very different. He had followed the process expecting a convergence of the risk weights or Probability of Loss and risk cost experience. Neither were happening, and so he had to admit that the portfolios were different and responded differently to the same macroeconomic inputs.

The same was seen across Europe. For example, the Spanish and Dutch mortgage books were the same, but the Spanish was slightly superior. He suggested that that was because the distribution model in the Netherlands focused mainly on third party distributors, whereas in Spain they only chased their existing payment clients.

Regulatory Uncertainty

A regulatory body representative outlined that when he spoke to bankers, investors and analysts, the main concern was regulatory uncertainty. There was currently too much uncertainty and it was difficult to invest in banking.

A lot of uncertainty came from the many decisions that still had to be made, which was why others had placed a large emphasis on the year's end. There was also pressure for them to close reform packages that had been agreed a long time ago. They were trying to close the process and move to a different stage. He said that nobody dreamed of finalising the outstanding regulations and standards more than he and his team.

He continued that they needed to clarify what they meant on regulatory uncertainty. First, the calibration of requirements that they had already agreed was an area with no regulatory uncertainty. Those pieces were being finalised; everybody knew what was coming and how it would be framed. It was therefore misleading to class it as uncertain.

However, there was uncertainty in two areas. First was the repair of internal models. Second was in providing clarity and ensuring consistency in the application of the reforms that had been completed so far. They had already seen turmoil in the market for additional tier one and two instruments, and part of that had been driven by a lack of understanding. Those were areas on which they had to give answers, as regulators, quickly.

An industry representative agreed, on Europe, that there was a process and that they had come a long way. It was true that uncertainty in the implementation of rules was damaging the industry, and so the authorities needed to hurry up and provide a clear interpretation.

He outlined that many things had happened since 2010. The impression was that things were adding up and they did not have a clear understanding in Europe of where they were and what the impacts would be. He asked where the legitimacy was in Europe.

He explained that a friend of his had said that they wanted smaller banks in Europe; however, his friend was from an American bank that was growing in Europe. He suggested that the European Parliament may have wanted more and larger American banks, and smaller European banks, which was fine. However, he noted that he did not fully understand the process in Europe.

A banking representative explained that when investors came to buy their bonds, they asked what his organisation was going to do about the Basel proposals. He did not think that the Danish regulators would put the risk weight up to 25%, but they had to be able to answer questions on it because their neighbouring countries had it. They needed more capital, quickly. That was the uncertainty that they faced, and which was difficult for them.

He understood that well capitalised banks were better than banks that were not well capitalised. If they needed more capital, they would try to get it. He agreed that the more capitalised his clients were, the better price they would get, and the higher the probability that they would give them a loan.

He stated that the problem was that they did not know how much capital they needed. If they were going to change prices for their customers, they needed to communicate it. If they told their customers that they needed more capital for new rules, before they arrived, they would have trouble. They had already experienced trouble in Denmark when they had tried to raise prices; uncertainty was the biggest problem.

Implementation Fragmentation

A regulatory body spokesperson explained that on application the key challenge would be with Pillar II. They still had many differences in the way that it was applied. However, they were committed to ironing out the differences and providing clarity to the market on how that would work. The next step was to give clarity to the MREL and Pillar categories. That would be a challenge, but he hoped that the regulatory uncertainty would disappear quickly.

A public authority speaker agreed with everything that had been said on the implementation of regulation. He agreed that the main goal was to resolve the issues that resided in the definitions in order to reduce differences in the risk weighted asset calculations.

A speaker outlined that one of the concerns within the European Parliament, when making rules, was keeping a level playing field inside the EU 28 to ensure that the way they calculated did not differ. She noted that banks outside of the eurozone were a source of fear for those that tried to ensure that things were calculated similarly both inside and outside of the Banking Union.

Addressing Inconsistency of Risk Weighted Asset Calculations

A public authority representative said that in order to reduce difference in the risk weighted asset calculations, there were three problems. First was improving the standard model. Second was improving the internal models. Third was implementing the leverage ratio as an alternative to capital requirements.

There were questions on those three problems. First was that there were reasons to think that some portfolios could not be individually modelled, and had to be studied in a standard model. He noted that input and output floors needed to be considered in the discussion. They also had to define how they implemented leverage ratio. They had already taken some decisions, but others were still pending.

A banking sector representative explained that when considering models in practice they experienced that models tended to be more effective if used for both regulatory and business purposes. If a model calculated regulatory capital as well as managing risk/reward on individual loans and portfolios to price transactions, then those models had the most attention, best data, and most frequent scrubbing. Ultimately, first, second and third line could align behind and work with those models. They had a situation of two parallel universes in one bank, in which the same inputs led to different conclusions. He stated that the more they desensitised those models for risk, the bigger the problem would become.

They saw that in some of the latest proposals. They were also seeing, in the current proposals, that getting the level of capital right was becoming less accurate, rather than more.

The third point was on low default portfolios. They had been given very high risk weight in the latest proposals. They could not ignore that low defaults probably indicated that PDs were low. He argued that they could theoretically say that a PD of a low default portfolio was one minus the non default cases they had; non default was an observation. However, they did not have observations on the Loss Given Default. He understood that they wanted to be conservative there, but the combination of the two could not lead to the risk weights that they were seeing, which worried them.

He suggested that they often had low default portfolios either because not many defaults happened, or because the transactions that they did with those clients were self liquidating, which happened a lot. He liked to think that they would never experience a loss, or would exit before there was a real problem, but felt that it perhaps did not happen as often as he would have liked.

A Risk Weighted Approach to Banking Regulation

A speaker on behalf of a regulatory body had three points on the risk weighted approach that they had towards banking regulation. First was that he was not afraid of well capitalised banks or releasing capital requirements. He did not understand why, if bank customers were well capitalised and had access to lower funding costs, the banks were not in the same positions themselves.

Second was that he worried that they were increasingly looking for shortcuts to push for better capitalised banks, rather than working on plain capital requirements based on risk weights.

He had some words on undermining the risk based approach. The first was incentives; if they insisted that risk weights were defined according to a floor higher than the actual risk, the incentive to provide more careless lending would be there because banks worried about the level of capital. Second was on complexity. They currently had many ways of accounting for capital requirements. That was becoming fairly complex, which he was uncomfortable with. He feared that comparability would be hampered if they were to induce something not based on the true risk weighting, as could be assessed by supervisors.

Third was that risk weights were not perfect, which also hinted at where a solution could be found. He was a firm believer in stress testing and thought that there were virtues to the leverage ratio.

However, he stated that the problem was that insolvency legislation was one significant factor which made life very different across jurisdictions.

An industry representative wanted to clarify a misunderstanding; that bankers tried to talk down risk weights. He stated that for regulatory capital, not a lot of attention had ever been paid to the concept of concentration risk. Instead they focused on individual loans and clients. He stated that correlations killed banks, not individual loans, clients, or portfolios. He suggested that he would focus more attention there than on risk weighted modelling with a floor in terms of leverage, rather than any input or output combined with more attention to concentration.

Capital Floors

A regulatory body representative explained that one element of the proposals published on 24 March, which had attracted attention, was the prospect of an output floor. He explained that they were doing that to limit the benefits derived from banks using their models; and they had proposed a range of 60 90%. He stated that that was likely to be one of the last things that they did as they finished things during the course of the year.

A banking representative outlined that, regarding the more technical details, capital floors were one problem. He stated that, assuming that capital floors did not materialise because they already had a leverage ratio with a backstop, they could have to live with input or output floors in the models. He said that if they wanted to calibrate their capital levels, it had to be done through a portfolio of floors. That would give them the right ranking and make them able to maintain incentives for some solid risk management in the banking world.

He continued that mortgage lending in Europe was financed by issuing covered bonds. He stated that it was important that covered bonds were treated well in the coming years. That had been included in the liquidity rules in Europe, and they saw that the proposed treatment for covered bonds corresponded more or less with corporate bonds. He stated that that would harm the market and take up liquidity.

Supervision

An industry representative highlighted that the issue that had been missing from the discussion was the role of supervision and allocating capital. He said that the framework for the prudential regulation of the banking sector was essentially a three legged stool with risk based metrics, leverage ratio and stress tests.

To the extent that they were turning the risk based leg of the stool into a non risk based measure, there was a danger. He stated that each of the things that different individuals were doing over the year had real implications. Standardised measures were models themselves. They were consciously declared models, removed from the reality of the risk underlying whatever the instrument was. There were issues with that in terms of herding behaviour.

To the extent that there was a gap between the standardised measure and modelled number, he stated that they had massive potential for cliff effects, which raised questions about the model approval. When discussing the overall impact to the banking sector from the overall capital requirements not being significant, there were many underlying assumptions, including assumptions regarding full model approval, assuming that there would not be a floor inserted in between, calibrated at a level above the assumed model number versus the standardised number.

He outlined that it would eventually be important for them to discuss the role of supervision and whether the Basel Committee as a standard setter should have reached into perceptions of deficiencies of supervision. He said that the Basel Committee had completed a lot of good work and much of it had seemed like it was setting the stage for more intrusive work as supervisors, examining different supervisory practices. He said that it would be worth inserting that as a much more significant part of the Basel agenda, rather than taking the risk based leg of the three part prudential framework and turning it into another non risk based system.

The work that they were seeing over the course of the year was largely taking the risk based leg of that stool and turning it into a second non risk based leg. He felt that, ultimately, through rule setting it was trying to deal with perceptions of a lack of confidence in the Basel Committee's ability to do their supervisory tasks of examining models, measuring risk weighted practices inside firms, and other standard supervisory practices. He felt that it was worth looking into that.

A speaker on behalf of a regulatory body agreed. He stated that they had not stepped away from supervision, but were moving back towards it. He thought that the focus on capital was a distraction. They also had to consider the importance of risk management governance culture in banks. What the right amount of capital or precise risk weight was only obscured the bigger picture.

He agreed that there was a critical role for supervision, and they were clearly moving in that direction. The regulatory phase was drawing to an end, and in the work of the Basel Committee, the SSM and the Fed they were seeing a clear move from regulation, towards implementation and supervision.

Remaining Issues

A speaker highlighted the remarks that had been made on the lack of analyses of the cumulative effects of all the measures taken and works completed by separate bodies. An industry representative wanted to comment on the cumulative effects because he thought that there was a discrepancy between the ambition levels of the organisations driving that, and the realities at the level of a real bank looking at the consequences. They anticipated with the latest QIS and the consultation papers that they were looking at risk weighted assets doubling or perhaps tripling under the various iterations.

A banking sector representative asked, if they were sure that by reducing the risks to banks they were shifting risks into the market, who in the market would reduce risk. He said that, partially, that was happening and they were reducing risks in banks by shifting it into the market. Whether the taxpayer was better off, nobody had answered. He suggested that the Americans understood that they could not just shift risk to the market; the market had to be taken care of and the Federal Reserve was there. He asked if they were as prepared in Europe to intervene in the market in Europe and absorb some of the risks that had been shifted into the market, through the balance sheet of the Central Bank.

A public authority representative said that on overall assessment, they knew that that would be completed. The overall approach that had been developed in Basel was very consistent. After a period of excessive leverage, over extension and problems generated in the banks' trading books, the package of reforms had been consistent in strengthening the treatment of the trading book, reinforcing capital requirements, introducing a non risk weighted metric, and repairing the problems that were identified in the internal model. Looking at where the European banks currently stood, he was pleased with the strengthening that they had done.

However, there were issues. On models, they needed to maintain sensitivity in the risk weights. It would be key not to calibrate floors in a way that significantly removed that feature otherwise he would have agreed with those that said that they had risked having an unbalanced system.

They were also very aware of Pillar II and needed to do something. There were limits to what they could do as technical authorities. There were areas in which the legislation had left room for nationalities to implement things differently. They had tried to resolve that, but had eventually asked for intervention on the legislation from the Commission, which took time. They were working as fast as they could, but it was not always straightforward.

Conclusion

A speaker had three closing remarks. First, she agreed that since the beginning of the crisis the intention had been to make something coherent; and that sometimes, despite the intention, the result had been less coherent. She believed that in a 28-member union, the directives were no longer the correct instruments. Initially it had intended to leave some discretion to member states; the result had been a high price for delays and fragmentation.

They needed to take a costs and benefits approach to using different instruments. She noted that they perhaps needed to make fewer regulations, but also thought that room for creativity at a national level ought to be reduced.

Second, whatever the rules, the most important thing was supervision and the way that human beings used their intelligence. She stated that when creating rules, they always saw the implementation go in ways that they had not imagined. They therefore needed strong supervisors with tough powers.

The speaker stated that the fact that they had created a single supervisor in the eurozone had been a huge step. It was a huge achievement, despite there being many things to finish.

Finally, the speaker advised members of the industry to relax provided that there was no intention to destroy the banking sector in Europe. The banks were a strategic element of European sovereignty. If they had no more capacity to finance the industry, personal choices or preferences, then they were not capable of being strategic.

In some countries people had been elected by saying that finance was the enemy, but they had to admit that progress was possible. The speaker concluded that he hoped to keep the UK on board, but that whatever happened, they would carry on.