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ABBL views on the proposals of the de Larosière Expert Group

ABBL lobbyist registration number: 3505006282-58

Introduction

We think that strong and concrete measures in the field of prudential supervision and of financial stability are necessary in order to restore confidence in the global financial system. In that respect, we broadly welcome the general orientations proposed in the de Larosière report and endorsed by the European Commission in its communication of March 4, 2009.

In particular, we support the following recommendations:

- The European System of Financial Supervision (**the ESFS**) is a decentralised supervisory system that relies on the existing network of supervisors

- The ESFS is balanced, as it transfers some key responsibilities at EU level and recognises the role of local supervisors for the day-to-day supervision. In that respect, we agree with the breakdown of responsibilities detailed in Annex V of the report: "The allocation of competences between national supervisors and the Authorities in the ESFS"

- The ESFS provides a legally-binding mediation mechanism to settle the potential disagreements between supervisors of a college

- The ESFS, coupled with the proposed new authority in charge of macro-prudential supervision, the European Systemic Risk Council, will benefit financial stability

While considering the proposals as a very good discussion base, we would like to elaborate on three subjects: the scope of the ESFS, the issue of crisis management, and the governance and the structure of the future ESFS' new EU Authorities.

Office address: ABBL asbl • 59 boulevard Royal • Postal address: P.O. Box 13, L-2010 Luxembourg
Tel.: (+352) 46 36 60-1 • Fax: (+352) 46 09 21 • mail@abbl.lu • www.abbl.lu

The scope of the ESFS

Given that the current crisis is of a systemic nature, the future supervisory architecture should focus on systemic risk. In that regard, the ESFS should primarily focus on the micro-prudential supervision of the systemic banks, in order to complement the work to be undertaken by the ESRC, the future EU body in charge of macro-prudential supervision.

The de Larosière report includes in the scope of the ESFS **all cross border banks**, and leaves to national supervisors the supervision of **purely domestic banks**. We think that a distinction between **systemic** and **non-systemic banks** is more relevant in terms of financial stability and of supervisory efficiency. The rationale could be extended to the broader definition of systemic financial institutions, insurance, financial conglomerates, hedge funds, technical infrastructures, etc.

The systemic banks (and financial institutions) are large, complex and deeply interconnected among themselves; their failure thus creating a risk for the financial system as a whole. These characteristics make them “Too Big To Fail”, i.e. governments cannot afford to let a systemic bank become insolvent and do not hesitate to use public money in order to bail them out. The systemic banks therefore benefit from an implicit state guarantee, which creates a moral hazard and unhinges the level playing field vis-à-vis non-systemic banks.

The definition of the systemic banks should be based on a combination of qualitative and quantitative criteria to be applied at group level. **Quantitative criteria** could be

(i) the level of Tier one capital,
(ii) the ratio of foreign assets to total assets,
(iii) the ratio of foreign income to total income,
(iv) the ratio of foreign employment to total employment.

On a more **qualitative side**, the degree of complexity and of interconnectedness of a bank with the rest of the system should be assessed. The list of 43 EU cross-border banking groups drawn by the ECB and commonly agreed among stakeholders is a good starting point.

From an **operational** point of view, the EU systemic banks could be placed under the direct supervision of the new banking Authority, which would directly constitute and lead the colleges of supervisors, define the supervisory programme, allocate tasks among supervisors, etc. This solution would reconcile the demands of some big players (one single point of contact) with the imperative of the supervisory efficiency (consistency ensured among the colleges of supervisors).

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The revised ESFS that we propose provides an optimal trade-off between an appropriate level of financial stability and the supervisory burden necessary to reach this level of financial stability. Extending the scope of the ESFS to all cross-border banks in the EU would be marginally beneficial to financial stability, compared to the significant supervisory costs incurred. On the one hand, such an extension would create a bulky and expensive supervisory infrastructure. On the other hand, indirect costs would arise because it is not efficient to closely involve a central EU body in the daily supervision of small regional banks.

The other banks are not EU systemic: they are either regionally orientated and active in a few countries, or purely domestic and only active in their national market. These banks should remain under the supervision of national supervisors, making use where necessary of the cooperative framework (the colleges of supervisors) provided by the Capital Requirements Directive.

The material law must remain identical for all EU banks, be they systemic or not. The only difference between EU systemic and non-systemic institutions would be the identification of the supervisor and its level of implication in the conduct of the supervision.

The crisis management

The de Larosière Group does not bring any new development to the central issue of the crisis management: in case of bankruptcy of a cross-border bank, the financial responsibilities would thus remain national. The consequence is to exacerbate the **asymmetry** between the supervisors' **supervisory powers** and their **supervisory responsibilities**: supervisors would have to transfer to the EU Authority their supervisory powers while retaining the supervisory responsibilities for the banks that operate in their jurisdiction.

In line with our proposal on the scope of the ESFS, we think that the EU systemic bank groups supervised by the ESFS should ideally be subject to complete EU-wide financial stability arrangements, providing

- A single set of tools for crisis prevention
- Operational guidelines for crisis management
- A specific winding-up regime
- Common principles and ex-ante agreements for organising the cost sharing of a crisis resolution on the basis of equitable and balanced criteria involving the private and the public sector
- A single EU Deposit Guarantee Scheme

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The proposals of the de Laroisère Group must thus be completed, as far as permitted by the political reality, in order to pave the way towards a complete solution for the EU systemic banks.

For the EU non-systemic banks, be they cross-border or purely domestic, the financial responsibility could remain national.

The governance and the structure of the ESFS' new EU Authorities

The **governance** of the future EU Authorities must be clarified. In particular, the voting system should guarantee that decisions are taken in a neutral, effective and quick manner.

We think that a system of weighted majority identical to the Council's definition, which is primarily based on demographic weight, does not grant such guarantees of neutrality. Neither does it fairly reflect the expertise of all supervisors involved.

We propose that the future Authorities adopt the **"one member, one vote"** principle as a fundamental principle of their decision-making mechanism. This principle is already in use in the Governing Council of the ECB and in various EU Agencies like, for instance, the Agency for the European Aviation Safety Agency (EASA). Based on this principle, the majority could be defined as two-thirds of the votes.

From a **structural** point of view, the opportunity to constitute, from the beginning, a single EU Authority in charge of banking and of insurance supervision should be considered. Such a single Authority would ensure an efficient supervision of financial conglomerates that combine banking and insurance activities, would create synergies and economies of scale, and would alleviate the cost of supervision for the Community budget.

Concerning the ABBL:

The Luxembourg Bankers' Association (ABBL) is the professional organisation representing the majority of banks and other financial intermediaries established in Luxembourg. Its purpose lies in defending and fostering the professional interests of its members. As such, it acts as the voice of the whole sector on various matters in both national and international organisations.

The ABBL counts amongst its members universal banks, covered bonds issuing banks, public banks, other professionals of the financial sector (PSF), financial service providers and ancillary service providers to the financial industry.

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