

CURRENT DEVELOPMENTS IN THE REGULATORY FRAMEWORK OF THE EUROPEAN BANKING SYSTEM

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A. INTRODUCTORY REMARKS

1. Levels of regulatory intervention in the financial sector

a. International level (Basel Committee on Banking Supervision, IOSCO, FATF, OECD, CPSS)

b. Community level

c. National level

Currently, the principal source of regulatory intervention in the financial sector are the legal acts adopted at Community level within the context of achieving the integration of the internal market in the European Community.

A. INTRODUCTORY REMARKS

2. Reasons for regulatory intervention in the European financial sector

a. Necessary prerequisites – negative integration

Financial services trade liberalisation

b. Adequate prerequisites – positive integration

- Ensuring the stability of the banking system – capital markets – insurance market
- Ensuring that markets are fair, efficient and transparent
- Combating of financial crime
- Protection of consumers of financial services
- Efficiency of payments systems

A. INTRODUCTORY REMARKS

3. The role and significance of compliance

- a. The complexity of the regulatory framework which governs credit institutions:
 - renders compliance with it an increasingly composite process
 - increases the risk arising from non-compliance
- b. Compliance is an important parameter as concerns the exercise of sound corporate governance
- c. The risk from non-compliance with the regulatory framework in force consists in:
 - a risk of the imposition of legal sanctions
 - a risk of considerable financial losses
 - a risk of loss of reputation

A. INTRODUCTORY REMARKS

3. The role and significance of compliance (cont.)

Static function of compliance

The compliance function has as its objective:

- the identification, assessment and monitoring of the risk of a credit institution arising from non-compliance with the regulatory framework currently in force
- the ensuring of compliance of the credit institution with the regulatory framework currently in force

Dynamic function of compliance

The compliance function has as its objective the timely provision of information to the Management in connection with forthcoming developments in the regulatory framework, with a view to:

- the planning of the appropriate strategy
- the assessment of the effects of the forthcoming changes on the operation of the credit institution

A. INTRODUCTORY REMARKS

4. The role and responsibilities of the Management as concerns the monitoring of regulatory developments

- a. The Management of a credit institution bears the responsibility for the effective functioning of the credit institution
- b. The exercise of sound corporate governance presupposes an understanding of the regulatory framework governing credit institutions and the ensuring of an effective dialogue with the supervisory authorities
- c. The Management bears the responsibility for the effective management of the risk arising from incorrect application of the regulatory framework and for the implementation of the credit institution's compliance policy, for which it refers to the Board of Directors

A. INTRODUCTORY REMARKS

5. The role of the HBA

- a. It monitors developments at all levels and stages of the regulatory intervention (international, community, national)
- b. It intervenes at the stage of elaborating the regulatory framework with a view to promoting the positions of the banking system
- c. It elaborates the forthcoming regulatory developments and informs its member-banks in due time
- d. It assesses the implications of the regulations being adopted on the criterion of the most effective compliance of the banking system

B. THE EUROPEAN FINANCIAL REGULATORY FRAMEWORK

1. What rules are applied to credit institutions

- Operation and supervision of credit institutions (under C)
- Operation and supervision of capital markets (under D)
- Consumer protection (under E)
- Operation of payments and settlement systems (under F)
- Combating of financial crime
- Insurance mediation
- Personal data
- Tax law and accounting law
- Commercial law
- Labour law
- Environmental liability

B. THE EUROPEAN FINANCIAL REGULATORY FRAMEWORK

2. How the rules are produced

- **Legislative procedure**
 - Co-decision procedure
 - Lamfalussy procedure (under 3 below)
- **Self-regulation**
 - Codes of ethics
 - European Payments Council
 - Ombudsman

B. THE EUROPEAN FINANCIAL REGULATORY FRAMEWORK

3. Lamfalussy procedure

The Lamfalussy procedure concerns the way of producing rules in European financial law and was adopted by the Community institutions in 2002, initially in the capital markets sector. Its extension to the banking and insurance sectors was then decided in 2004

The Lamfalussy procedure consists in four levels:

Level 1

Aim: Adoption of a general regulatory framework and determination of the issues as to which technical implementing measures should be adopted by the European Commission

Procedure: Adoption of Community acts by the classic procedure of co-decision of the Council and the European Parliament on a proposal of the European Commission

B. THE EUROPEAN FINANCIAL REGULATORY FRAMEWORK

3. Lamfalussy procedure (cont.)

Level 2

Aim: Concretization of the framework principles of Level 1

Procedure: Adoption of technical implementing measures in the form of a Directive or Regulation by the European Commission. Provision of technical assistance by sectoral technical committees

Level 3

Aim: Joint interpretation and consistent implementation of the measures of Levels 1 and 2 at a national level

Procedure: Co-ordination of actions by the sectoral committees and issuing relevant guidelines

Level 4

Monitoring by the European Commission of the compliance of the Member States with the measures adopted

B. THE EUROPEAN FINANCIAL REGULATORY FRAMEWORK

	Level 1	Level 2	Level 3
Type of legal act	Basic legal act	Implementing measures	Recommendations / Guidelines
Legislator	European Parliament / Council	European Commission	CEBS/CESR/ CEIOPS
Support mechanisms	EBC/ESC/EIOPC (as advisory committees)	EBC/ESC/EIOPC (as advisory and regulatory committees) CEBS/CESR/ CEIOPS (as advisory committees)	

B. THE EUROPEAN FINANCIAL REGULATORY FRAMEWORK

4. What are the basic principles of the European financial regulatory framework

- Principle of mutual recognition
- Principle of minimum harmonisation
- Principle of partial harmonisation
- Principle of the exercise of supervision at a national level (in contrast with monetary policy)
- Principle of national treatment on the basis of reciprocity in relation to financial intermediaries of third countries

5. How national law is affected

- Regulations: immediate force
- Directives: obligation to implement
- Recommendations: possibility of implementation

B. THE EUROPEAN FINANCIAL REGULATORY FRAMEWORK

White Paper on Financial Services Policy (2005-2010)

- Better lawmaking
- EC regulatory and supervisory structures
- Ongoing and future legislative activities (2005-2010)
- The external dimension

C. OPERATION AND SUPERVISION OF CREDIT INSTITUTIONS

1. The new framework for the capital adequacy of credit institutions (Basel II)

- The new framework consists of:
 - Directive 2006/48/EC of the European Parliament and of the Council relating to the taking up and pursuit of the business of credit institutions (recast), and
 - Directive 2006/49/EC of the European Parliament and of the Council on the capital adequacy of investment firms and credit institutions (recast)
- The main objective of the new rules is to establish a comprehensive and risk-sensitive framework and to foster enhanced risk management amongst financial institutions.

C. OPERATION AND SUPERVISION OF CREDIT INSTITUTIONS

1. The new framework for the capital adequacy of credit institutions (cont.)

Time schedule for implementation of the new framework

- **2007:** Standardised and Internal Rating Based (IRB) Foundation method available
- **2008:** Internal Rating Based Advanced method also available
- Banks which opt for the adoption of the Advanced method will be free to remain during 2007 in the previous framework (Basel I)

C. OPERATION AND SUPERVISION OF CREDIT INSTITUTIONS

METHODS OF CALCULATING CAPITAL REQUIREMENTS		
Degree of risk sensitivity	CREDIT RISK	OPERATIONAL RISK
low	Standardised	Basic Indicator
medium	IRB foundation	Standardised Alternative Standardised
high	IRB Advanced	Advanced Measurement approach

C. OPERATION AND SUPERVISION OF CREDIT INSTITUTIONS

Methods of calculation of capital requirements for credit risk	
Method	Calculation of risk-weighted assets
STANDARDISED METHOD	<p>Five (5) predetermined risk weights (0 –150) depending upon:</p> <ul style="list-style-type: none"> • Counterparty credit rating, or • The type of transaction
IRB FOUNDATION METHOD	More risk weights with use of a special function for calculation of capital requirements by category of exposure
IRB ADVANCED METHOD	More risk weights with use of a special –more risk-sensitive- function for calculation of capital requirements by category of exposure

C. OPERATION AND SUPERVISION OF CREDIT INSTITUTIONS

Parameters of Internal Rating Methods	
PD	Probability of Default - PD Likelihood that a loan will not be repaid
LGD	Loss Given Default - LGD Recovery rate in the event of default
EAD	Exposure At Default – EAD Estimation of the extent to which a bank may be exposed to a counterparty in the event of default
M	Maturity - M Duration of the exposure

C. OPERATION AND SUPERVISION OF CREDIT INSTITUTIONS

1. The new framework for the capital adequacy of credit institutions (cont.)

Amendments to the existing regulatory framework / Pillar I

What does not change

- The portfolio for the calculation of capital requirements for credit risk
- The minimum level of capital requirements (8%)
- The definition of own funds (small change)
- The framework for the calculation of capital requirements for market risk (small change)

C. OPERATION AND SUPERVISION OF CREDIT INSTITUTIONS

1. The new framework for the capital adequacy of credit institutions (cont.)

Amendments to the existing regulatory framework / Pillar I (cont.)

What changes

- The framework for the calculation of capital requirements for credit risk
 - New methods
 - Risk mitigation techniques
 - Securitisation
- Introduction of capital requirements for operational risk
- Pillars II and III

C. OPERATION AND SUPERVISION OF CREDIT INSTITUTIONS

NO CHANGE

Regulatory Capital

Value exposed to:

credit risk + market risk + operational risk



Level of capital requirement 8%

NO CHANGE

CHANGE

NO CHANGE

NEW

C. OPERATION AND SUPERVISION OF CREDIT INSTITUTIONS

1. The new framework for the capital adequacy of credit institutions (cont.)

Amendments to the existing regulatory framework / Pillar II

- Credit institutions should have a process for assessing their overall capital adequacy in relation to their risk profile and a strategy for maintaining their capital levels
- Supervisors should review and evaluate credit institutions' internal capital adequacy assessments and strategies, as well as their ability to monitor and ensure their compliance with regulatory capital ratios
- Supervisors should expect credit institutions to operate above the minimum regulatory capital ratios and have the ability to require credit institutions to hold capital in excess of the minimum (8%) ratio
- Supervisors should seek to intervene at an early stage to prevent capital from falling below the minimum levels required to support the risk characteristics of a particular credit institution

C. OPERATION AND SUPERVISION OF CREDIT INSTITUTIONS

1. The new framework for the capital adequacy of credit institutions (cont.)

Amendments to the existing regulatory framework / Pillar III

Disclosure of data of a qualitative and quantitative character:

- Incorporation into the price of a credit institution's securities of disclosed information
- Changes in the cost of raising capital (financing) and of risk premiums as the risk profile of the bank's portfolio alters

C. OPERATION AND SUPERVISION OF CREDIT INSTITUTIONS

2. Directive 2007/44/EC as regards procedural rules and evaluation criteria for the prudential assessment of acquisitions and increase of holdings in the financial sector

- The Directive will streamline the criteria and timescale of the assessment procedure applied by European supervisory authorities in cases where qualifying holdings are acquired in the financial sector
- The adoption of this Directive is a decisive step towards strengthening European competitiveness in particular by promoting cross-border consolidation

C. OPERATION AND SUPERVISION OF CREDIT INSTITUTIONS

3. Commission's Consultation on reorganisation and winding up of credit institutions (Directive 2001/24/EC)

The purpose of Directive 2001/24/EC is to ensure that a credit institution and its branches in other Member States are reorganised or wound up according to the principles of unity and universality

Main issues of the consultation

- i) the problems of cross-border reorganisation and winding-up of banking groups, and the obstacles to the transferability of assets in a crisis situation; and
- ii) gaps and ambiguities in the current Directive identified so far

C. OPERATION AND SUPERVISION OF CREDIT INSTITUTIONS

4. Committee of European Banking Supervisors (CEBS)

The current issues:

- Liquidity risk
- Review of the large exposures regime
- Supervision in third countries
- Commodities business
- Options and discretions in the CRD
- Definition of own funds

D. OPERATION AND SUPERVISION OF CAPITAL MARKETS

1. Markets in financial instruments (MiFID)

Level 1

- **Directive 2004/39/EC** on markets in financial instruments

Level 2

- **Directive 2006/73/EC** of the Commission on organisational requirements and operating conditions
- **Regulation 1287/2006/EC** of the Commission on record-keeping and market transparency

D. OPERATION AND SUPERVISION OF CAPITAL MARKETS

1. Markets in financial instruments (MiFID) (cont.)

CESR Level 3 measures:

- Protocol on the supervision of branches under MiFID
- Passport under MiFID – Recommendations for the implementation of the Directive and Statement on practical arrangements regarding the late transposition of MiFID
- Protocol on MiFID Passport Notifications
- Q & A on best execution
- Inducements under MiFID
- List of minimum records
- MiFID transaction reporting
- Publication and consolidation of markets data

D. OPERATION AND SUPERVISION OF CAPITAL MARKETS

2. Clearing and settlement in the EU

- Giovannini barriers
- European Code of Conduct for Clearing and Settlement (FESE, EACH, ECSDA)
- CESR/ESCB Standards for Securities Clearing and Settlement in the EU

D. OPERATION AND SUPERVISION OF CAPITAL MARKETS

3. TARGET2-Securities

- On 6 July 2006, the Governing Council of the European Central Bank decided to further explore in cooperation with central securities depositories and other market participants, the setting up of a new service –called TARGET2-Securities – for securities settlement in the euro area
- The objective of the project is to allow the harmonised settlement of securities transactions in euro which are settled in central bank money. Synergies for the market with other facilities operated by the Eurosystem will be sought, in particular in connection with the future TARGET2 payment system
- The Governing Council of the ECB intends to hold another public consultation by the end of 2007, requesting comments on fully articulated user requirements. Only after this public consultation the Governing Council will decide on the development phase

D. OPERATION AND SUPERVISION OF CAPITAL MARKETS

3. TARGET2-Securities (cont.)

Objectives

- Provide a single venue where all EU assets can be exchanged for euro
- Reduce cost of cross-CSD settlement via a single settlement platform and standardized communication protocols
- Reduce complexity and associated operational costs and risks by harmonizing market rules and practices for clearing and settlement related corporate events

Benefits of T2S on post-trading

- Increased market liquidity and access to wider investor base lead to lower cost of capital for issuers
- Increased market liquidity and lower cost of portfolio diversification lead to better return for investors

D. OPERATION AND SUPERVISION OF CAPITAL MARKETS

4. Investment Management

- White Paper on enhancing the Single Market framework for investment funds
- European Parliament: Draft report on Asset Management II

Purpose: Review of the Directive 85/611/EC by the end of 2008

D. OPERATION AND SUPERVISION OF CAPITAL MARKETS

5. Other issues

- **Investor protection and transparency**

Commission Recommendation on the electronic network of officially appointed mechanisms for the central storage of regulated information referred to in Directive 2004/109/EC of the European Parliament and of the Council

- **Prospectuses**

Assessment of the application of the Prospectus Directive and the Regulation
Level 3 measures under preparation

- **Market abuse**

Level 3 measures under preparation

D. OPERATION AND SUPERVISION OF CAPITAL MARKETS

5. Other issues (cont.)

- **Credit Rating Agencies**

European Commission's request for CESR to review the role of Credit Rating Agencies

Main issues for consideration

- Transparency of Credit Rating Agencies (CRAs) rating methodologies,
- Human resources allocated to rating and monitoring,
- Periodic monitoring of the ratings and timeliness of rating actions,
- Potential conflicts of interest (i.e. remuneration structures of CRAs)

E. CONSUMER PROTECTION

1. Proposal for a Directive on credit agreements for consumers

Main issues

- The principle of responsible lending: a. duty to provide explanations and b. obligation to assess the consumer's creditworthiness
- Provision of exhaustive pre-contractual information
- Introduction of new provisions on the way of calculating the Annual Percentage Rate of Charge
- Right of withdrawal: period to exercise the right of withdrawal is 14 days

The Plenary of the European Parliament is expected to adopt the Directive in December 2007 or January 2008

E. CONSUMER PROTECTION

2. Future expected developments in the field of consumer protection

- *Green Paper* on Bank Accounts and Customers' Mobility: the aim is the improvement of customer mobility in relation to bank accounts
- *White Paper* on retail financial services: policy proposals and concrete measures proposed as regards retail financial services
- *White Paper* on Mortgage Credit: policy orientations and concrete measures proposed as regards mortgage credit
- *Review of the Directive 2002/65/EC* concerning the Distance Marketing of Consumer Financial Services on the conclusion of cross-border contracts
- Publication of a Report on the Review of the Consumer Acquis

F. OPERATION OF PAYMENT and SETTLEMENT SYSTEMS

1. SEPA

SEPA is the area in which:

Citizens, firms and other economic agencies will be able to make electronic payments in euro in the European Economic Area with the same conditions, rights and obligations, regardless of their country of establishment

The political dimension of SEPA

Focus on the Eurozone: SEPA will be delivered to the countries of the Eurozone as a priority

Countries which do not belong to the Eurozone will be able to participate in the pan-European systems of payments and will be able to adopt the relevant standards and practices to contribute to the single euro payments market

F. OPERATION OF PAYMENT and SETTLEMENT SYSTEMS

1. SEPA (cont.)

- The EPC is a self-regulatory decision-making organisation of the European Payment Industry
- The development and delivery of competitive 'SEPA Payment Schemes' are a competence of the EPC
- The adoption of the 'SEPA Payment Schemes' will be:
 - a decision of the EPC and the national banking systems, so that they can develop the basic prerequisites (e.g., capability of delivery) in due time
 - a decision of each bank so that it can provide its clientele with SEPA payment services
- The adoption of 'SEPA Schemes' at a national level to supplement or replace existing 'infrastructures' at national level is a decision for the national banking communities
- Within the framework of PE-ACH, the possibility of merging the national ACHs is a decision for the users and/or shareholders

F. OPERATION OF PAYMENT and SETTLEMENT SYSTEMS

1. SEPA (cont.)

Launching of SEPA payment instruments

- 1.1.2008, SEPA for Cards (at least one card payment product with EMV chip)
- 28.1.2008, SEPA credit transfers for citizens and business
- 1.11.2008, SEPA direct debits for citizens and business

F. OPERATION OF PAYMENT and SETTLEMENT SYSTEMS

2. TARGET2

- The Trans-European Automated Real-time Gross settlement Express Transfer (TARGET) system went live in January 1999, at the same time as the introduction of the euro
- In October 2002, the Governing Council of the ECB decided to develop the next generation of TARGET (TARGET2)
- In 2003, three national central banks of the euro area - the Deutsche Bundesbank, the Banque de France and the Banca d'Italia - offered to jointly build and operate the SSP on behalf of the Eurosystem

F. OPERATION OF PAYMENT and SETTLEMENT SYSTEMS

2. TARGET2 (cont.)

- Under TARGET2 the decentralised structure of the current TARGET system will be replaced by a single technical platform, the so-called Single Shared Platform (SSP)
- TARGET2 is envisaged to start operations on 19 November 2007