POSITION PAPER

The ESBG's response to the Financial Stability Board's Principles for an Effective Risk Appetite Framework

ESBG (European Savings and Retail Banking Group)

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ESBG Transparency Register ID 8765978796-80

25 September 2013

I. General comments

The Financial Stability Board (FSB) received the mandate from the G20 to develop more stringent supervisory rules for systemically important financial institutions (SIFIs). In an attempt to ensure a more effective Risk Appetite Framework (RAF), the present Consultation Paper contains comprehensive, detailed requirements applicable first and foremost to the frameworks that need to be implemented by SIFIs. We welcome the draft principles in the respect that we believe it is important to create a common global framework, in particular, the creation of a common terminology.

Yet, at the same time, the FSB also recommends transferring the principles to all other financial institutions and to have their compliance verified by national supervisors. However, from our point of view, the FSB's detailed requirements concerning the RAF should exclusively apply to SIFIs. In this context it is worth noting that several Member States have already implemented a principle based framework for minimum requirements with regard to banks' risk management, specifically concerning the underlying risk strategy, risk capacity and risk limits. These frameworks are often already sufficient for an appropriate risk appetite framework of banks. In several Member States these requirements already apply to all banks and they have been tested and tried in practice. Notwithstanding the foregoing, should there be a genuine need to subject all banks to more clearly detailed requirements, in our view, these rules should reflect the nature of high level principles to a greater extent.

Given the rationale of the Consultation Paper, our following comments are based on the assumption that there will be a broad scope of application (i.e. our following comments are based on the understanding that the proposed requirements shall be applicable to all financial institutions).

II. Specific Comments

Rationale for the objective and its achievement

Initially, we would like to point out that the Consultation Paper's objective and the contribution which the proposed rules will make in meeting this objective should be explained in a more compelling manner. In our view, the explanation given in order to justify the appropriateness and effectiveness of the requirements for globally systemically important institutions and particularly for all other banks remains inadequate.

Reduction in the level of detail of the requirements

We have major concerns over the requirements' level of detail. In our view, there is a risk that the rules' level of detail will force banks into preparing a rigid regulatory framework which might – *de jure* – comply with the provisions proposed in the Consultation Paper but which – for all intents and purposes – will no longer be understood by a bank's staff and which will equally fail to generate any additional, decision-useful information for supervisors. Presumably, this will lead to a lack of acceptance for the regulatory framework, and an implementation of the requirements that is largely unaware of the underlying risks and at the expense of the practical fitness for purpose.

At this point, we would like to highlight a non-exhaustive list of examples for excessively tight or, moreover, rigid regulation:

- Implementation of risk limits on the level of business lines or, moreover, legal entities – respectively expressed relative to earnings, capital, liquidity or other relevant measures (e.g. growth, volatility)(c.f. 3.1 b);
- Preparing a comprehensive list in order to single out or, moreover, specify the roles and responsibilities of the CEO, CRO and CFO (cf. 4); in this context, the board has to question senior management regarding its activities outside the approved risk appetite framework (c.f. 4.1 g).

Furthermore, it is essential that it is made clear that the more detailed requirements in subsection 4.1 do not relate to the parent company´s obligations towards the subsidiaries within a group. Even though a parent company has the overarching responsibility for the group, it is too far-reaching to impose an obligation to micromanage the subsidiaries.

In general, we would like to reiterate our preliminary understanding that the current proposals shall have a broad scope of application. Hence, we hold the view that the Consultation Paper's proposals should take greater account of the heterogeneity of the banking community on the whole. Contrary to a detail-oriented approach, in Europe a regulatory approach that is based on high-level principles including the so-called principle of double proportionality has stood the test of time.

For example the German "Minimum Requirements of risk management" first and foremost seeks to ensure that a bank - depending on its size, the complexity of its business activities and its risk profile – complies with the intents and purposes of the minimum requirements in an appropriate manner. Conversely, the same approach applies to the supervisory review of compliance with the requirements. This approach extends to all material regulatory subjects: from defining the risk appetite in the risk strategy to financial planning and capital planning, risk limitation and risk monitoring up to the definition of specific tasks during risk management.

Hence, in order to enhance the focus on principles and processes, we would like to suggest an increased emphasis of the high-level nature of the proposed framework. In our view, the forthcoming regulation should primarily focus on the following areas:

- Establishing the risk appetite on the basis of the business strategy and risk strategy;
- The definition of the risk appetite should be confined to a limited number of mandatory features;
- Reflection of the risk appetite in business plans and capital planning;
- Definition and review of the risk limits.

About ESBG (European Savings and Retail Banking Group)

ESBG – The European Voice of Savings and Retail Banking

ESBG (European Savings and Retail Banking Group) is an international banking association that represents one of the largest European retail banking networks, comprising of approximately one-third of the retail banking market in Europe, with total assets of over €7,600 billion, non-bank deposits of €3,500 billion and non-bank loans of €4,200 billion (31 December 2011). It represents the interests of its members vis-à-vis the EU Institutions and generates, facilitates and manages high quality cross-border banking projects.

ESBG members are typically savings and retail banks or associations thereof. They are often organised in decentralised networks and offer their services throughout their region. ESBG member banks have reinvested responsibly in their region for many decades and are a distinct benchmark for corporate social responsibility activities throughout Europe and the world.

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Published by the ESBG, September 2013