FINANCIAL STABILITY BOARD

Press release

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FSB completes peer review of Germany

The Financial Stability Board (FSB) published today its peer review of Germany.

The peer review examined two topics that are important for financial stability: the macroprudential policy framework and microprudential supervision. These topics are relevant across the FSB membership and are also being covered in other FSB peer reviews. This review focused on the steps taken by the German authorities to implement reforms in these two areas, including by following up on relevant recommendations in the 2011 Financial Sector Assessment Program (FSAP) report by the International Monetary Fund (IMF).

The German authorities have made good overall progress in addressing the FSAP recommendations on both topics, although several elements of the reforms are still ongoing. Going forward, the authorities need to expeditiously develop and implement a comprehensive macroprudential strategy, and to further strengthen the banking and insurance supervisory frameworks in order to enhance risk identification and allow for timely intervention in financial institutions. An important driver of developments in this context has been, and will continue to be, initiatives undertaken at the European Union level.

The reforms in institutional and organisational arrangements introduced by the German Financial Stability Act (October 2012) broadly address the FSAP recommendations on the macroprudential policy framework. In particular, the law delineates statutory responsibilities for financial stability in Germany; establishes the Financial Stability Committee (FSC) and mandates the Bundesbank to provide it with substantial analytical support, including the identification of systemic risks and the formulation of recommendations to mitigate them; specifies arrangements for cooperation and information exchange between the Bundesbank and the Federal Financial Supervisory Authority (BaFin); and provides for backstop powers to collect additional information from financial institutions.

The FSC is already functional but, with just about a year of existence, it is too early to evaluate effectiveness in attaining its mandated objectives. The framework underpinning the FSC will need to be clarified and fine-tuned as processes crystallise and as more experience is gathered. The FSC will also need to promptly develop a macroprudential strategy and operationalise it. The review noted that the strategy should be comprehensive and address aspects of the FSC's institutional design that are not yet fully clear. These include specifying:

- the role of the FSC vis-à-vis its member institutions on certain financial stability issues;
- an analytical framework for triggering, monitoring and assessing the impact of warnings and 'comply or explain' recommendations;

- a comprehensive macroprudential toolkit on an *ex ante* basis to ensure the timely application of relevant tools if the need arises; and
- a strategy to maximise the effectiveness of FSC communication to target audiences.

The peer review also found that good progress has been made in response to the FSAP recommendations to enhance the microprudential supervisory framework for banks and insurers. In particular, the stress testing framework and coverage for banks and insurance companies has been enhanced; the regulatory reporting framework for both sectors has improved; and the intensity of on-site supervision for larger banks has increased. Regulatory initiatives at both the global and European level have shaped the direction and pace of German reforms in this area.

An important development impacting banking supervision in Germany will be the commencement of the Single Supervisory Mechanism (SSM) on 4 November 2014. On this date, primary responsibility for the supervision of the largest banks in the Euro area, including an expected 24 German banks, will be transferred to the European Central Bank (ECB). National authorities will remain involved in the supervision of those banks, as it is expected that they will assist the ECB in the performance of its new supervisory tasks. For smaller banks, national competent authorities will retain responsibility with ECB oversight. These changes will have a significant impact on the roles, responsibilities and tasks of both BaFin and Bundesbank as well as on current supervisory practices.

While these changes pose uncertainties and challenges, the peer review encouraged the German authorities to continue their efforts to enhance supervisory frameworks and processes. In particular, the transition to the SSM does not lessen the need to further strengthen supervisory practices in Germany to ensure the early and comprehensive identification of risks within each institution as well as to enhance the timeliness, consistency and effectiveness of supervisory interventions. Relevant measures include: enhancing the analysis of business models and risk culture; ensuring that supervisors are informed at an early stage of major acquisitions by supervised banks and are able to take steps to address any risk implications; increasing credit risk expertise; incorporating liquidity risk scenarios in the stress testing framework; increasing on-site inspections for insurance companies; and expanding the use of a ladder of supervisory actions when deficiencies are identified.

Notes to editors

The FSB has been established to coordinate at the international level the work of national financial authorities and international standard setting bodies and to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies in the interest of financial stability. It brings together national authorities responsible for financial stability in 24 countries and jurisdictions, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts. The FSB also conducts outreach with 65 other jurisdictions through its six regional consultative groups.

The peer review of Germany is the eleventh country peer review conducted by the FSB and the fifth using the revised objectives and guidelines for the conduct of peer reviews set forth in the December 2011 *Handbook for FSB Peer Reviews*. FSB member jurisdictions have committed to undergo an FSAP assessment every five years and, to complement that cycle, an FSB peer review two to three years following an FSAP. As part of this commitment, Germany volunteered to undergo this peer review in 2013. In 2014, the FSB will launch country peer reviews for China, Netherlands, Russia, Saudi Arabia and Turkey. All completed peer review reports are available on the FSB website.

Country peer reviews focus on the implementation and effectiveness of regulatory, supervisory or other financial sector standards and policies agreed within the FSB, as well as their effectiveness in achieving desired outcomes. They examine the steps taken or planned by national authorities to address IMF-World Bank FSAP and Report on the Observance of Standards and Codes recommendations on financial regulation and supervision as well as on institutional and market infrastructure that are deemed most important and relevant to the FSB's core mandate of promoting financial stability. Country reviews can also focus on regulatory, supervisory or other financial sector policy issues not covered in the FSAP that are timely and topical for the jurisdiction itself and for the broader FSB membership. Unlike the FSAP, a peer review does not comprehensively analyse a jurisdiction's financial system structure or policies, or its compliance with international financial standards.

The report published today describes the findings and conclusions of the peer review of Germany. The draft report was prepared by a team of experts drawn from FSB member institutions and led by Arthur Yuen, Deputy Chief Executive, Hong Kong Monetary Authority. The review benefited from dialogue with the German authorities and from discussion in the FSB Standing Committee on Standards Implementation.

The FSB is chaired by Mark Carney, Governor of the Bank of England. Its Secretariat is located in Basel, Switzerland, and hosted by the Bank for International Settlements.

For further information on the FSB, visit the FSB website, www.financialstabilityboard.org.