

SPEECH CAPITAL REQUIREMENTS – GLOBAL OR EUROPEAN

Chairman, Members of Parliament, Mr Chairman of CEBS, colleagues,
Thank you for the opportunity to share some thoughts today on one of the key drivers of our business: a sound and comprehensive risk management. ABN Amro welcomes the translation of Basel II into the proposed Capital Requirement Directive which, if transposed successfully, will foster enhanced risk management among financial services firms. This will deliver greater financial stability in the EU, maintain confidence in financial institutions and protect depositors. In the end this will not only benefit the European banking industry but the whole European economy as was foreseen in the Lisbon agenda.

Let me walk you through some of our key points on how the Global and European dimension are equally important in the implementation of Basel II.

The global dimension

From a global perspective it is key for us that a flexible Directive with a high degree of parallelism with the new Basel II framework is implemented. The proposed Directive should avoid putting European Member States at an unlevel playing field in comparison with other OECD or non-OECD countries. To ensure competitiveness of Europe's financial markets, alignment is key with the Basel 2 framework in terms of timing, implementation and substance. This to avoid unnecessary implementation costs and increased complication of the implementation because of different requirements inside and outside the EU.

To respond to this challenge, we refer to the key role of CEBS to achieve at the one hand a high degree of parallelism in implementation and on the other hand to embed future enhancements and recalibrations. Those enhancements will be derived from Quantitative Impact Studies currently conducted both by the Basel Committee and prominent supervisors. Furthermore, I would like to reiterate our call for a single implementation date in January 2008. The Commission's staggered approach would confront internationally active banks with different dates in and outside the EU, which would not only increase costs but also, more importantly, could undermine the stated objective of increased market transparency. Indeed, the transitional arrangements as proposed by the Commission lack clarity and focus and each supervisor will interpret them in its own way which will lead to an uneven

implementation in the single market and legal uncertainty for cross border groups.

The Basel framework is work in progress. We believe that the Directive should reflect any changes made to the Basel II framework before or after the implementation date. A flexible Directive is key to respond to developments in the market. The Directive needs in particular to incorporate the changes that will come out of the review of the trading book undertaken by the Basel Committee and IOSCO as soon as they become available so as to remain competitive in the global market.

In this context a fast adoption of the Directive is essential for the benefits of the legislation to be realised as quickly and prudently possible. Any delay would put European banking industry at a disadvantage in the global market.

A true Single European Market

Creating a true single market in terms of risk management is in the interest of both the borrowers and depositors. However, a few obstacles remain on the road ahead.

The first roadblock is the divergent application of EU law in the Member States.

The high number of national discretions in the proposed Directive could give rise to an uneven implementation. These national discretions should therefore only be temporary and should be included in the annexes of the Directive so that they could be revisited at a later date. We welcome the work of CEBS in streamlining these national discretions as a first step in the right direction

However I want to stress the importance of another, often forgotten, but even more fundamental roadblock. Supervisors might have different interpretations in applying standards in the new CRD in areas such as rating validation, stress testing and the internal capital adequacy assessment process (“ICAAP”). Here again I advocate further strengthening of the role of CEBS to generate the optimal level of supervisory convergence in the implementation of CRD whilst fully acknowledging national specificities.

A workable Directive for banks

In order to have a Directive for banks that is both applicable in practice and will even be generally applauded for its consistency and accuracy it is crucial that it will not turn into a ‘tick box exercise’ nor in an unnecessary accumulation of conservative assumptions by regulators.

Let me elaborate on these two points.

Firstly, a rules based approach with regulators ticking boxes of long lists of detailed qualitative and quantitative requirements could be misleading as to

the firm-wide risk profile of the financial institution involved and thus should be avoided at all cost. It is the essence of the banking industry to add value by continuously exploring new routes and developing more advanced products and services. The mandate of the regulators should therefore be to safeguard the interests of the stakeholders of a bank by making sure a bank's capital should at all times be sufficient to endorse the risks it incurs or could incur taking full account of new developments in the industry as well as product innovations. In this ongoing evaluation by regulators, the CRD serves as the ultimate guidebook. We therefore strongly urge for a principles-based approach allowing essential breathing space to the bank's internal risk management and giving regulators room for flexibility in the application of rules. The CRD should never be reduced to a pure compliance exercise, which would prevent it from becoming an embedded part of a bank's internal risk management and business practice as well as from fostering innovation. Simply put, banks should act in the spirit of the principles laid down in the CRD. I reiterate that prudent supervision must supersede strict rule application.

Secondly, in line with these thinking lies a call to avoid a further accumulation of conservative assumptions in capital cost calculations. The combination of Pillar 1 conservative assumptions with downturn and stressed parameters and Pillar 2 capital add-ons related to stress tests and validation data shortage might ultimately widen the gap between a bank's internal risk based capital measurement and the regulatory capital requirement to such an extent that banks will turn their backs on the regulatory capital framework for their internal business decision making. This would defy both the purpose and the opportunity created by years of fine work in both the Basel Committee and by the European Union. In this respect, we urge for further recalibration of all assumptions once well grounded empirical evidence is available and hence for a flexible CRD in the spirit of the Lamfalussy procedure. On both points we see again a crucial role for CEBS.

Let me go now into our **specific concerns** with regard to the proposed CRD. We basically have three top concerns:

- the role of the consolidating supervisor;
- the level of application of the rules; and
- the risk weighting of intra-group exposures.

ABN Amro strongly supports the enhancements proposed in article 129 on the role for the consolidated supervisor in the proposed Directive. It will first improve the information flows relating to cross border financial groups and secondly strengthen the obligation for European supervisors to co-operate. In the proposal the role of the consolidating supervisor is however limited to the validation of advanced models pertaining to pillar 1.

Business practice today shows that banks increasingly manage risk using a group wide model based on business lines and evolved away from the traditional country based model. We think that it is important that the CRD matches this business reality and ask therefore for an extension of article 129 stipulations to Pillar 2 with a special focus on the so-called ICAAP process, i.e. the assessment by regulators of the internal capital adequacy assessment process. We cannot emphasize enough that an integrated, systematic approach to risk assessment is not limited to a firm's organizational structure but also is a key driver for internal portfolio and business management. Such an integrated approach implies the use of group wide models taking into account all diversification and correlation effects between portfolios, risk categories and even between clients. The full application of Pillar 2 at solo level would largely affect such an approach and in addition could well lead to inconsistent supervisory treatment.

This however should not preclude host supervisors from taking their responsibility in their local markets and from providing their very valuable input in the the other main process contained in Pillar 2, the Supervisory Review Process. To make the process effective and not overly burdensome for both regulators and financial institutions their role should however be well defined and co-ordinated. We believe that CEBS has a key role to play in advancing supervisory co-operation and convergence whilst at the same time respecting and giving full appreciation to local differences.

Our second concern relates to the level of application of the rules.

In the current proposal, calculation of capital requirements takes place at the level of each individual entity within the group or in other words at solo level. This requirement has major repercussions.

The proposed Directive gives Member States the option to waive the solo level application and to apply the rules at consolidated level but only within their Member State if certain conditions are met on the allocation of capital. This could lead to a competitive disadvantage between those banking groups domiciled in a Member State whose competent authority does not apply the waiver and those groups in Member States whose competent authorities do apply the waiver.

Whilst acknowledging that the conditions to the waiver should be subjected to supervisory discretion, we don't believe that it should be restricted to national boundaries as there is no prudential justification for this restriction which is also contrary to the objective of the Single Market. As a minimum it must be extended to the whole EU market.

More on a general note, it is our view that consolidated supervision should be ultimately envisaged to become a general rule for the whole new CRD: pillars 1, 2 and 3.

On top of the arguments already stated earlier, applying the minimum capital requirements on an individual basis leads to an additional, unnecessary administrative burden and even in some cases to double counting. From a purely pragmatic point of view we think it is in the interest of both banks and supervisors to at least allow host supervisors the right to relay their responsibilities to home supervisors as is stipulated in the current Directive. Summarising, consolidated supervision will encourage convergence of supervisory practices in the EU and thus strengthen Europe's financial stability.

The treatment of intra-group exposures is our third concern.

The current proposal introduces a national discretion stipulating that competent authorities may exempt from capital charges all *domestic* intra-group exposures. This would allow credit institutions to apply a 0% risk weight to domestic intra-group exposures. Not only is this a national discretion but the restriction to *domestic* intra-group exposures has in our view no prudential justification and is in addition contrary to the objectives of the Single Market as it leads to an uneven competition between domestic banks on the one hand and internationally oriented banks on the other hand. The impact of weighting intra-group exposures would lead to enormous cost increases for the latter category. We believe that this should not be a national discretion but a general rule, which should be applied to all intra-group exposures within the consolidated and centrally managed banking groups in the EU.

In conclusion, I would like to stress again that the global and European dimension of the implementation of the Basel II framework are closely intertwined. If we want to meet the objectives of the Lisbon agenda we have to take both dimensions into consideration when working on the successful implementation of a Capital Requirement framework in Europe.

To summarise, for an international active bank such as ABN AMRO and more general for the European market, it is crucial that the CRD is flexible and aligned both between Member States and to the extent possible, with the Basel II framework. CEBS and European supervisors must apply the principles and closely follow new developments in the banking industry. More concretely we would like to see the role of the consolidating supervisor model be extended to pillar 2, the waiver in Article 69 to be conditional but applied at European level and the exemption on intra-group exposures to be uniformly applied across the EU.

It is important for the banking industry to get it done now but we have to get it done right.

Ladies, Gentlemen, I would like to conclude that we are getting views of Basle on the horizon, however a few high mountains remain to be conquered!