



ECB-RESTRICTED
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STRENGTHENING MACRO AND MICRO-PRUDENTIAL SUPERVISION IN EU CANDIDATES AND POTENTIAL CANDIDATES

A programme funded by the European Union

Project Summary

(not for publication)

A programme implemented by the European Central Bank in partnership with the Nationale Bank van België/Banque Nationale de Belgique, the Bank of Greece, the Banco de España, the Banque de France, the Banca d'Italia, the Central Bank of Cyprus, the Banque centrale du Luxembourg, the Central Bank of Malta, De Nederlandsche Bank, the Oesterreichische Nationalbank, the Banco de Portugal, Banka Slovenije, Národná banka Slovenska, Suomen Pankki – Finlands Bank

A. Synopsis

The project was not part of the original 2011-2013 Private Sector Development Plan, it was however included in the framework of the EU EUR 360 million Crisis Response Package, which was approved in principle by the European Council in December 2008. The project was implemented throughout 2010-2011 and completed in January 2012 with a closing event in Frankfurt, the European Central Bank (ECB) headquarters.

The project aimed at strengthening the medium-term resilience to financial stress of EU candidates and potential candidates, in particular by:

- supporting the adjustment of macro and micro-prudential supervision in line with the most recently agreed international and EU standards
- sharing and transferring expertise and know-how to benefit supervisors of the beneficiaries
- increasing networking among experts in the region, including with euro area institutions.

The project was implemented by the European Central bank in partnership with 14 of the euro area National Central Banks, under a coordinated Eurosystem approach. It was addressed to central banks and supervisory institutions of the eight EU candidates and potential candidates, in as much as they perform macro- and micro-prudential supervisory functions.

Other institutions were actively associated with the implementation, including:

- the Basel Committee on Banking Supervision (Basel),
- the Committee of European Banking Supervisors (London),
- the Center of Excellence in Finance (Ljubljana),
- the European Banking Federation (Brussels),
- the European Parliament (Brussels and Strasbourg),
- the Financial Stability Institute (Basel),
- the International Monetary Fund (Washington),
- the Joint Vienna Institute (Vienna) and
- the World Bank (Washington).

The project pursued three policy goals in parallel:

- 1) To inform authorities of the beneficiaries about deliberations that had taken place or were being prepared for consideration, within the framework of discussions by international financial institutions (e.g. the IMF and the World Bank) by other international bodies (e.g. the G20 process, the Financial Stability Board and the Basel Committee on Banking Supervision) as well as in the European Union (by the European Commission, its consultative groups and by other official bodies and institutions, including the ECOFIN Council, the Committee of European Banking Supervisors and the European Parliament). The aim was to provide institutions of beneficiaries aspiring to join the EU with up-to-date knowledge on banking supervision and support them in the implementation of sound supervisory practices.
- 2) To inform these authorities about developments in home-host cooperation at the international and European level. The provision of specific training should strengthen their technical capacity to interact in the activities of colleges of supervisors.
- 3) To inform the regulators and legal experts in the eight countries – inter alia through ad hoc training programmes – about progress on regulatory reform in EU banking legislation, in order to facilitate the adjustment of laws and best practices to EU standards and the incorporation of the EU *acquis communautaire* into domestic legislation.

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The programme was structured in three interconnected Components:

1) Regional training courses, for implementation in 2010 (Component One)

Training activities included policy workshops for board members and senior management of the beneficiary institutions, as well as training events for regulators and middle management of the beneficiary institutions. This component also provided for the admission to training activities offered by the CEBS for one officer of each beneficiary institution and access to FSI Connect for up to 110 participants.

2) National measures, during the first half of 2011 (Component Two)

Experts from Eurosystem central banks implemented measures benefiting the eight EU candidates and potential candidates. These activities had been previously identified in cooperation between the ECB, the Eurosystem partner national central banks and the IMF and the World Bank, to ensure full compatibility with the FSAPs jointly conducted by the two international institutions.

3) Technical simulation exercises focusing on cross-border cooperation, during the second half of 2011 (Component Three).

Technical simulations tested the technical capacity of beneficiary authorities in home-host cooperation, involving the Eurosystem partner central banks, and the IMF and the World Bank. Communication in both normal working procedures among home and host authorities and crisis situations were simulated. They followed the pattern of similar exercises conducted in other regions of the world under the leadership of the World Bank.

B. Project evaluation and suggestions for further work

The following section presents the main conclusions from the evaluations conducted for each component. Future cooperation activities could build on these findings.

Component One

Component One consisted of a series of 20 training events in 2010 on macro-prudential supervision, micro-prudential supervision, home-host cooperation and regulation. It also included training events organised by the Committee of European Banking Supervisors and the online learning tool FSI Connect offered by the Financial Stability Institute. The evaluation of Component One was strongly positive and it was considered that it fully achieved its objectives. Suggestions for future work included:

- *Home-host supervision:* As this issue is of special interest for the region the focus on that topic should be increased.
- *Calculation of capital requirements:* Additional practical training also regarding early warning methods and stress testing.
- *ICAAP, Basel II / Basel III, IFRS 9:* evaluation, implementation and assessment.
- *Risk management:* tools and models of risk management, credit risk mitigation, credit risk management, liquidity risk evaluation (EU country experiences).
- *SREP, supervision:* SREP evaluation, implementation of supervisory standards, contact, cooperation and exchange of views with colleagues from the supervisory colleges.
- *EU Directives, Economic law, Banking law, Financial law:* legal aspects of securities markets derivatives, payment systems, implementation of EU CRD central credit registers IAS 39.
- *Financial stability and home-host cooperation:* lessons from the crisis, evaluation of financial stability, building indicators, procyclicality of capital.
- *Technical seminars:* stress testing, IT implementation of regulatory issues, implementation of consumer protection.

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In terms of methods, it was suggested that for future activities the focus could usefully shift from the teaching of fundamentals to practical implementation, exchange of experience in interactive sessions and case studies.

Component Two

Component Two consisted of the following twinning activities undertaken in the first half of 2011 between Eurosystem central banks and beneficiary institutions.

Beneficiary	Topics	Partner NCB(s)
Croatia	1. Implementation of the ICAAP	Oesterreichische Nationalbank
Macedonia, FYR	1. Review of the structure of the NBRM risk-based supervisory approach (SREP including supervisory planning) 2. Review of Risk assessment system (RAS, including risk profile of a bank)	Banka Slovenije
Turkey	1. Development of early warning system 2. Macro stress testing (establishment of the new framework, more forward looking approach)	National Bank of Belgium European Central Bank
Albania	1. Macro-prudential supervision 2. Macro stress testing Support in implementing a risk assessment system	Bank of Greece Banca d'Italia
Bosnia and Herzegovina	1. Support in building up a Risk assessment system (Methodology, guidelines) 2. Support in building up the basis and structure of the Supervisory Review Process (SRP) Market conduct regulation and supervision	Banque de France Banco de Portugal
Montenegro	1. Implementation of Pillar 2/Risk assessment system 2. Licensing of banks 3. Financial reporting and IAS	Národná banka Slovenská
Serbia	1. Review of NBS market risk assessment – Capital requirement calculation (position risk, FX and commodities risk) and risk assessment; definition of trading book, general rules for breaking down the positions of particular instruments, use of internal models 2. Review of NBS provisioning rules (regulatory perspective) 1. Implementation of the ICAAP 2. Early warning system	Banque de France Oesterreichische Nationalbank
Kosovo*	1. Assessing and upgrading current Early warning system 2. Macro-prudential/financial system stability/macro stress testing	Bank of Finland

Evaluation of Component Two was strongly positive. Excellent cooperation among the experts and the delivery of concrete and tangible outcomes were highlighted, as well as highly beneficial contacts made for future cooperation.

Interest to continue with the successful bilateral activities was maintained by participants and the following topics for potential future cooperation were highlighted:

- *Calculation of capital requirements*: support in designing guidelines on management of different types of risks, link between supervisory review and capital adequacy ratio.

* This designation is without prejudice to positions on status, and is in line with UNSCR 1244 and the IC J Opinion on the Kosovo Declaration of Independence.

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- *ICAAP, Basel II / Basel III, IFRS 9*: assistance for developing guidelines for the evaluation of the banks' ICAAP and SREP methodology, rules for the identification and management of different types of risks within Pillar II.
- *Risk management*: further training on interest rate risk, concentration risk and operational risk assessment.
- *EU Directives, Economic law, Banking law, Financial law*: definition of core areas of consumer protection and amending the law to EU Directives, IT support.
- *Financial stability*: forecasting the development of bank balances.

In terms of methods, the close cooperation between the beneficiaries and the Eurosystem central banks was emphasised. To enhance this cooperation it was suggested to intensify study visits and practical implementation.

Component Three

Component Three consisted of two Crisis Simulation Exercises conducted by the World Bank. The employed scenario within the exercise comprised four (fictitious) national jurisdictions hosting local subsidiaries of four (also fictitious) regional banking groups. These banking groups were subject to supervision by their home supervisors in their respective (also fictitious) home countries. Throughout the duration of the exercise, a sequence of problems were arising, directly or indirectly affecting the financial stability of the four host jurisdictions.

There were two types of participants in this exercise: "Players" and "Role-Players." Players were the experts of the beneficiary countries, who represented (played) national financial authorities (decision makers). Role-players were the members of the World Bank team, representing the staff of national supervisory agencies ("line supervisors"), bankers, journalists, politicians, etc., and the experts from euro area institutions, who represented the home supervisors of the regional banking groups. The team representing the financial authorities of each fictitious jurisdiction composed of experts from exclusively one beneficiary country (no mixed teams). While the names and other characteristics of the fictitious jurisdictions were unrelated to specific beneficiary countries, the teams had to base their actions and decisions on the existing laws and regulations of their own countries.

Participants expressed their appreciation of the exercise as very beneficial and insightful. Some of them also identified a few gaps in the regulatory framework of their own (real) country during the exercise. They concluded that the exercise had revealed the importance of information sharing. They also mentioned that host-host cooperation can be beneficial and needs to be strengthened in practice. Some of them also mentioned that it would be useful to repeat the exercise in the future and or complement it with an exercise at the national level, possibly focusing on a qualitative assessment of the actions taken during the exercise rather than only on communication.