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Public Hearing on Financial Regulation and Supervision

Panel I: To what extent did financial regulation and supervision fail in preventing the crisis?

Brussels, February 25th, 2010

Allianz

The main causes for the crisis (1/2)

- Excessive use of leverage instruments
- Under estimation of correlation and interdependency between financial institutions as well as different asset classes
- Excessive liquidity injected both by central banks (esp. US) as well as by governments (public deficits)
- Insufficient regulatory environment in some key countries
- Rating agencies apply inadequate rating models and are not subject to adequate supervision, conflicts of interest
- Intransparent and not sufficiently harmonized accounting standards

The main causes for the crisis (2/2)

Corporate Governance

- Inadequate asset / liability and liquidity management
- Inadequate pricing and handling of risks (Subprime US)
- Short-term compensation / incentive schemes
- Inadequate influence and competences for risk management and compliance functions in financial institutions
- Too many market participants in search for unsustainable high returns not adequately considering the risks accompanied therewith

Some general considerations

- Financial sectors of the respective countries were affected differently (e.g. guaranteed bailout / GDP from high double digits to below 1%)
- EU insurance sector proved to be clearly more stable than banking sector
- Different competences and quality of financial regulators contributed to the differences

Regulatory tools (1/5)

- Organization and principles of supervision
- Quantitative solvency requirements
- Consumer / investors protection
- Corporate governance (Pillar II)

Regulatory tools (2/5)

Organization and principles of supervision

- Necessity of a coordinated European supervision
- Supervision at European and national level must interact in a harmonized manner
- Supervision needs to be principles based
- Solvency and accounting standards must be calibrated to avoid pro-cyclical behavior
- Evident differences between banking and insurance sector must be considered

Effective supervision, but no bureaucracy and uncoordinated reporting requirements

Regulatory tools (3/5)

Quantitative solvency requirements

- Capital adequacy ratios should more adequately reflect market, spread and liquidity risk
- Consistent stress testing including off and on B/S liquidity exposures
- Eligibility of certain asset classes to capital and reserve coverage
- ALM rules
  (to limit excessive short term refinancing of long-term lending)

Adequate balance between capital requirement and necessary long term competitiveness must be ensured

Regulatory tools (4/5)

Consumer / Investor Protection

- Product Transparency
- Product Adequacy

→ Adequacy of Risk / Return profile

- Stringent rules for consumer credits / mortgage loans
- Supervision of rating agencies

But consumers must also understand that above average returns are linked to above average risks

Regulatory tools (5/5)

Corporate Governance

- Risk management / compliance function in financial institutions must be strengthened
- Risk management needs to become part of the DNA of the organization
- Transparent and homogeneous accounting rules
- Compensation guidelines / principles
  - Transparency
  - Link to risk adjusted metrics
  - Inclusion of midterm targets
  - Deferred compensation schemes

Corporate Governance needs to be based on common ethical values

Summary

- We need more coordinated well calibrated supervision on EU level
- Financial, solvency supervision and consumer protection must be carried out in a coordinated and harmonized manner
- Corporate Governance to be based on clear ethical values
- We need an enhanced and continuous dialogue between supervisory authorities, politics and financial institutions

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