Bettina Corves-Wunderer

Public Hearing on Financial Regulation and Supervision

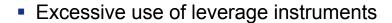
Panel I: To what extent did financial regulation and supervision fail in preventing the crisis?

Brussels, February 25th, 2010





The main causes for the crisis (1/2)



- 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

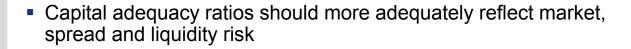
Effective supervision, but no bureaucracy and uncoordinated reporting requirements





Regulatory tools (3/5)

Quantitative solvency requirements





- 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



Adequacy of Risk / Return profile

Product Adequacy



Supervision of rating agencies

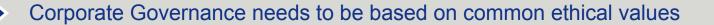
But consumers must also understand that above average returns are linked to above average risks



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





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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