

Minutes

**Minutes of the second meeting of the
PILLAR TWO STANDING GROUP**

Held on 22 April 2005 - 15:00pm

At LIBA, 6 Fredericks Place, EC2

Present:

Katharine Seal (LIBA)
Uner Nabi (IMA)
Helen Banks (APCIMS)
Chris French (BSA)
Patrick Fell (PwC)
Peter Humphreys (HSBC)
Martin Whiteley (Barclays)
Adrian Haines (RBS)
Martin Davies (Nationwide)
Chris Chaloner (Man Group)
Simon Wren (J P Morgan/Cazenove)
Tim Carroll (SCB)
Simon Neville (Collins Stewart)
Hugh May (Ipswich Building Society)
Steve Teather (Merrill Lynch)
Graham Warner (J O Hambro Capital Management)
Philip Dearing (Market Harborough Building Society)
Guillaume Leveziel (Hargreaves Lansdown)
Simon Baker (Lloyds TSB)

Rosemary Hilary (FSA, RRD) - Chair
Marcia McFarlane (FSA, Pillar 2 Team, RRD) - Secretariat
Keith Pooley (FSA, Pillar 2 Team, RRD)
Tom Crossland (FSA, Pillar 2 Team, RRD)
Stephanie Courtin (FSA, Pillar 2 Team, RRD)
Nick Devereux (FSA, Pillar 2 Team, RRD)
Claire Haydon (FSA, MRGD)
Eva Horacek (FSA, WFD)
Nick Fisher (FSA, RFD)
Valerie Lachman (FSA, WFD)
Noel Clarcken (FSA, PSD)

Apologies:

Simon Hills (BBA)
Anthony Bellchambers (FOA)

**Minute
No**

Action

1. **Agenda Item 1 & 2 – Introduction and Draft Minutes to be approved and New Members**

Members to submit comments on draft minutes by 26 April 2005.

Rosemary Hilary opened the meeting with a thank you to LIBA for agreeing to host the Pillar 2 Standing Group meeting.

Rosemary welcomed new members to the Standing Group: Martin Whiteley from Barclays, Philip Dearing from Market Harborough Building Society, Guillaume Leveziel from Hargreaves Lansdown and Simon Baker on behalf of Richard Warren from Lloyds TSB.

Members were asked for their comments on the draft minutes. None were suggested. Members were invited to submit comments by email to the FSA by Tuesday 26 April.

Members were also reminded that minutes of the meeting would be posted in due course to the FSA website where presently the Terms of Reference and the Membership of the Standing Group were recorded.

2. **Agenda Item 3 – Pillar 2 Plan and CEBS update**

Keith Pooley circulated three draft papers to the Standing Group, which were expected to be published by CEBS by the end of May:

- *Revised CEBS Consultation Paper on the application of the Supervisory Review Process.*

Keith Pooley explained that the consultation paper had been expanded to include a section on internal governance commensurate with Article 22, Capital Requirements Directive and expanded upon how the ICAAP and SREP would work together.

Keith confirmed that the consultation papers superseded earlier publications and had been amended to reflect industry responses.

- *Guidelines for co-operation between Home-Host Supervisors.*
- *Interest rate risk in the banking book*

Keith Pooley asked the group to submit their comments to him by mid-May to enable him to co-ordinate responses to CEBS.

3. **Agenda Item 4 – Updates on specific Pillar 2 risks**

Interest rate risk in banking book – Noel Clarcken

Noel Clarcken introduced the draft CEBS paper on interest rate risk in the banking book. One member sought confirmation on whether, if 15% of a firm's balance sheet were held in bank deposits, the requirements would apply to such a firm. Noel said that it could potentially be the case, if they were held in the non-trading book. Keith Pooley added that it was not the intention to capture asset managers – instead the requirements were intended to apply to credit institutions and only those proprietary trading firms with significant interest rate exposures in their non-trading books. The FSA was trying to develop a test which would seek to ensure that only these firms had to apply the requirements which would include standardised reporting. Keith explained that there was no desire either at the European level or within the FSA to require a large amount of standardised reporting which would be at odds with a Pillar 2 regime which was essentially free format; however it was important to establish some basis on which peer group comparisons could be made.

One member believed that this was an area where both the FSA and the banks were learning and that over time this is an area that would grow and consequently at this stage it would be wrong to set the requirements in stone.

Noel explained that there would be a further meeting with BBA/ALMA and that comments from that meeting would be passed to CEBS in time for the end of May deadline and in addition would contribute to the next FSA Consultation Paper on implementing the CRD.

One member firm suggested paragraph 3 of the draft paper be amended to make clear that interest rate risk in the trading book 'is covered' rather than as stated 'is thought be to be covered' under market risk.

Procyclicality / Stress Testing – Keith Pooley

An expert group on Procyclicality and Stress Testing has been established under the umbrella of the Credit Risk Standing Group and has already met several times. The meetings have been

productive with interesting discussions, in particular, about the extent to which the outcome of any procyclicality stress tests would be emphasised in capital allocation, or encompassed in management actions or trigger points. The expert group was developing its thinking on this.

Keith Pooley confirmed that the subject would be progressed through CEBS.

4. **Agenda Item 5 – Pillar 2 Quantitative Impact Cost Benefit Analysis**

Tom Crossland circulated a revised Pillar 2 questionnaire which reflected previous comments. He explained that, subject to the FSA being able to articulate a view about expected overall capital movements (pillar 1 and pillar 2), then the FSAs preferred approach to the Cost Benefit Analysis was to base it upon a 'top-down' view rather than gather 'bottom-up' information through a questionnaire.

One member felt that firms would want to keep the process as simple as possible and that a top-down approach was adequate and less invasive.

5. **Agenda Item 6 – Pillar 2 Calibration**

Tom Crossland reported that, based on the feedback received so far from trade bodies and firms, the FSA was minded not to specify a confidence level to which firms might choose to calibrate their ICAAPs. Tom explained that the FSA approach was, however, likely to require firms which had developed models using a confidence level assumption to be able to explain that assumption and provide a range of results across a range of assumptions.

Tom explained that the FSA would then be able to compare the capital level the FSA felt appropriate for particular firms. However because the FSA's view would not be based, in the first instance, on a particular confidence level, it would not be possible to justify it to a firm in these terms. He believed nevertheless that this was a sensible approach because this was still a new area, where both firms and the FSA were 'feeling their way', but the ability to compare results with confidence levels would help ensure some consistency between firms.

One member sought clarification on what Tom meant by not being in a position to justify how it had arrived at its decision.

Tom Crossland explained that he was not suggesting there would

be no discussion with firms about the perceived risks or that there would be any secrecy regarding the process, but that both firms and the FSA were likely to be cautious about expressing their judgments in quantified confidence level terms.

One member sought clarification on how, absent guidance on confidence levels, the FSA would manage consistency between supervisors. Tom confirmed that this would necessarily be more of a challenge but that there would be a panel to review ICG decisions and provide consistency.

Rosemary Hilary confirmed that in the absence of specified confidence intervals the process would be harder to manage, as there would be a greater reliance on qualitative judgements; nevertheless this could be managed by more peer group reviews and training for FSA staff.

Tom Crossland also said that the FSA felt a better understanding of the confidence level implied by Pillar 1 would in due course be useful to help develop Pillar 2 techniques.

6. **Agenda Item 7 – AOB**

Nick Devereux gave an update on the 'pre-pilot' exercise. He explained that the purpose of the pre-pilots was to assist the FSA to devise an internal Supervisory Review and Evaluation Process that would work for all firms, to understand how firms are constructing their ICAAPs, and to give firms an insight to the FSA process.

Nick Devereux explained that, to date, five firms had volunteered to participate in the pre-pilot. Initial meetings with three of the firms had proved very helpful and meetings with the two remaining firms were set-up for next week. Nick sought additional volunteers from the investment firms in the Standing Group.

7. **The next meeting date was confirmed as 3rd June 2005 at 3.00pm at the FSA's offices.**