
Minutes

Minutes of the eighth meeting of the

PILLAR 2 STANDING GROUP

Held on 3 March 2006 - 14:00

At FSA, Committee room A&B

Attendees:

Chris Chaloner (Man Group)	Shirley Hensher (Nationwide)
Chris French (Building Societies Association)	Simon Neville (Collins Stewart Tullett)
Fiona Taylor (Hargreaves Lansdown)	Stephen Randall (Citigroup)
Gavin Smyth (Barclays)	Uner Nabi (Investment Management Association)
Graham Warner (JO Hambro Capital Management)	Zeyn Adam (Abbey)
Hasan Kazmi (Standard Chartered Bank)	Rosemary Hilary (FSA, RRD) - Chair
Helen Banks (APCIMS)	Keith Pooley (FSA, Pillar 2 Team, RRD)
Hugh May (Ipswich Building Society)	Tom Crossland (FSA, Pillar 2 Team, RRD)
Ian Russell (HBOS)	Stephanie Courtin (FSA, Pillar 2 Team, RRD)
Jonathan Gray (RBS)	Ian Rawlinson (FSA, Pillar 2 Team, RRD)
Katharine Seal (LIBA)	Nick Devereux (FSA, Pillar 2 Team, RRD)
Kim Patel (BBA)	Simon Gibbs (FSA, Pillar 2 Team, RRD)
Marco Bensi (Goldman Sachs)	Amber Robertson (FSA, MRGD)
Martin Davies (Nationwide)	Yvonne Braun (FSA, Policy)
Mike Parrott (Market Harborough Building Society)	Yannick Cox (Banking Sector Manager)
Nick Walsh (CSFB)	Gerard Lynch (FSA, WFD)Nathan Douglas
Patrick Fell (PwC)	(FSA, RFD)
Peter Humphreys (HSBC)	Nick Fisher (FSA, RFD)
Philip Gowman (JP Morgan)	Tom Tait (FSA, RFD)
Richard Groves (Lehman)	
Richard Warren (Lloyds TSB)	

Apologies:

Andrew Soundy (HBOS)

Jane Green (Futures and Options Association)

John Whittaker (Barclays Capital)

Len Sinclair (RBS)

Simon Baker (Lloyds TSB)

Simon Hills (BBA)

Simon Wren (JP Morgan)

Mike Pollitt (Nationwide)

Steve Teather (Merrill Lynch)

Dana Komlossyova (FSA, Pillar 2 Team, RRD)

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1. Agenda Item 1: Welcome

Rosemary Hilary welcomed new attendees to the Standing Group: Fiona Taylor from Hargreaves Lansdown, Philip Gowman from JP Morgan (an alternate for Simon Wren), Kim Patel from the BBA (for Simon Hills) and Shirley Hensher from Nationwide (for Mike Pollitt). Apologies were received from Steve Teather and Jane Green.

Rosemary Hilary noted that the emphasis of the meeting this time was on the FSA receiving feedback on agenda items including sessions from each of the trade associations.

2. Agenda item 2: CP February 2006

Tom Crossland introduced the recently published CP06/3. In response to a question he explained that the FSA wanted this to go to as wide an audience as possible. With this in mind firms should not be hesitant about printing and distributing copies.

A large part of the Pillar 2 content of the consultation paper had been discussed by this group in previous meetings. The areas covered included: detail on the supervisory process that the FSA has developed; a confirmation of emphasis away from prescription and confidence levels towards stress and scenario testing; and details of policy developments on procyclicality and diversification.

The consultation period this time is short with the closing dates for comments being 28 April 2006. Initial reactions to chapter 4 (Pillar 2) were invited.

Members welcomed specific references to the proportional nature of

the Pillar 2 regime.

One member noted that documenting the ICAAP would require the generation of material not currently produced and wondered whether the FSA would require this material to be available from day one. Tom Crossland replied that the FSA aimed to give firms three months notice of when ICAAP related material was required. While recognising the point being made, we did not want this to be a duplicative exercise and thought that the format would be similar to that which would be submitted to the board of directors

One member asked if larger firms could expect to be reviewed first. Tom Crossland replied that it was a judgement call to be made by the supervisor and at this stage there were no firm plans around the timetable. However, those firms that represented a higher priority would be considered first. In addition, there was likely to be some fitting around Arrow reviews and a dialogue to understand when firms wished to be reviewed.

Keith Pooley added that the FSA would also seek to link Pillar 1 waiver applications and ICAAP reviews. Where possible it was expected that ICAAP reviews would take place approximately three/six months following the consideration of the waiver. However, no rigid timetable has been agreed and the reviews may equally take place later or overlap with the waiver process.

One member asked for clarification around the UK consolidation rules. Tom Crossland explained that detailed rules were now included in the Handbook (GENPRU 1.2) which defined the UK consolidated group for Pillar 2. However, consideration would be given to what was considered to work best in practice and the FSA would consider a reasonable submission providing it was meaningful. He added that while the rules required a single entity to have a view on capital there was no rule on how the entity formed that view. It would not be unreasonable for the entity to leverage a group level assessment.

One member asked about how this worked on a cross-border basis. Keith Pooley explained that the FSA would look at an ICAAP from a group perspective for UK groups. In situations in which the UK was the host country we would recognise that the firm was part of a wider group and that the local ICAAP submission would have to draw from its group-wide ICAAP, albeit that we still expected it to have sufficient content to be able to make a supervisory assessment.

One member pointed out that the consultation paper focussed on the SREP rather than what was to be expected from an ICAAP. Keith

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Pooley explained that one needed to read the new paper in conjunction with the previous one (CP05/3) which had concentrated more on the ICAAP.

One member queried the wording in the overview section 1.9 which specified that the FSA would seek a capital add-on under Pillar 2 or take other measures if a firm was unable to demonstrate that it could survive a recession. Tom Crossland confirmed that this was ultimately the case, but only if the FSA was not persuaded as to the adequacy of the firm's capital plan and attendant management actions.

The FSA is keen to continue to provide practical guidance and to that end the Pillar 2 section of the practical information for firms part of the website would be populated in due course. Initial items include the suggested ICAAP template and the slide pack outlining the SREP framework.

Members welcomed publication of the suggested ICAAP format.

3. Agenda item 3: Questionnaire for investment firms

Stephanie Courtin introduced the questionnaire by clarifying that whilst the questionnaire will apply to all investment firms regardless of size or activities, its input into the SREP will be differentiated between type of activity and level of sophistication. For non-relationship managed firms the questionnaire will form the basis of the Pillar 2 assessment with an additional dialogue only taking place for outliers. For relationship managed firms the annual questionnaire will inform a dialogue that will take place in line with the supervisory period.

One member asked if a waiver would be available for larger firms that would be subject to additional dialogue in order to reduce the burden on the firm. Stephanie Courtin replied that internally the FSA has an appetite to receive the questionnaire from all firms and so there was likely to be only a limited number of cases for which we would be willing to consider a waiver. Rosemary Hilary added that there was nothing in the questionnaire that we would not reasonably ask in the course of a review. If there were difficulties for a firm to submit the questionnaire then that would need to be looked at on a case-by-case basis.

One member asked if a single questionnaire applied across a group. Stephanie Courtin confirmed that the scope of the questionnaire is the same as that of Pillar 2 (i.e. the UK consolidated group or each entity within that group if the group has been granted a waiver from

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consolidated requirements). The questionnaire does not apply to a group which contains a UK credit institution nor to banks or building societies. The questionnaire will be consulted on in the Integrated Regulatory Reporting consultation paper.

One member thought that the language might be confusing. For instance the Fixed Overhead Requirement (FOR) was not the same as operational risk and some firms would not be able to allocate capital to specific risks. Stephanie Courtin replied that the granularity of the questionnaire was necessarily limited so only those risks that were included in the Handbook text were also included here. Despite this reduced level of detail, all firms should be able to consolidate their reporting under those headings. Further, the firms should seek to demonstrate that the FOR is sufficient to cover the risks they have identified. For that purpose, they will need to identify and quantify the risks before they can compare the outcome with the FOR.

One member noted that a point had been raised at Operational Risk Standing Group regarding the definition of the term “risk appetite”, which might also be relevant in the context of Pillar 2. Stephanie Courtin replied that the FSA was open to suggestions and that the Pillar 2 team would remain in contact with the operational risk team to ensure consistency on this issue.

One member questioned the logic behind the question relating to the percentage of dealing errors with specific concern about how this might be applied to larger firms. Stephanie Courtin replied that this information was viewed as an indicator of how a firm manages its business generally. However, for larger firms it should be remembered that the assessment was not limited to information in the questionnaire.

4. Agenda item 4: CEBS draft paper on stress testing

Keith Pooley touched on the draft paper on stress testing. The paper is a result of nine months of discussion by CEBS members. The paper will likely be submitted to CEBS on 22 March along with the earlier papers on interest rate risk from non-trading activities and concentration risk.

Assuming CEBS adopts them, these papers are likely to have a short consultation period with a view to issuing final guidance by September.

Stephanie Courtin summarised the feedback she had received to date. Many thought that the paper was ahead of its time in that,

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although it described standards firms would generally aspire to, they would take time to achieve. In that sense the paper was deemed to be aspirational. Tom Crossland pointed out that Pillar 2 was about encouraging risk management practices. It was acknowledged that this was the early stage of a regime that would evolve.

One member asked how, given the many different levels of stress testing, thinking would develop into a more practical consideration. Tom Crossland answered that the Handbook includes material which had anticipated what was expected from CEBS, on stress testing.

Keith Pooley added that CEBS was sensitive to industry feedback. One member suggested that if CEBS was releasing aspirational material then there should be a clearer indication of what standards should be met and when. Keith Pooley noted this point and said he would prepare some redrafting of the cover note.

One member said that the paper could potentially introduce a lot of stress testing that served no meaningful purpose, and suggested that the concept of proportionality could be adopted whereby firms focus on those stress tests that are most appropriate for their particular business mix. Stephanie Courtin agreed that this could be highlighted more.

5. Agenda item 5: Update from the industry associations**Investment Management Association**

Uner Nabi introduced the guidance that the IMA was proposing to issue to its members.

IMA members representing large and small firms and different product types had asked for some practical guidance on ICAAP implementation.

It was felt that guidance was especially needed for smaller firms that do not have the resources to analyse and understand all of the new rules and consultation papers.

APCIMS

APCIMS main work has been to ensure that issues of proportionality and visibility are being recognised.

It is often the case that smaller firms do not formalise their risk management and so there is some work ensuring that members are aware of the requirements of Pillar 2 and how they can formalise their existing processes to fulfil these requirements. However,

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APCIMS is keen to stress to firms that there is no prescribed way in which this might be achieved.

No detailed guidance specific to Pillar 2 has been issued pending the publication of CP06/3. However, seminars have been held and it is intended that more of these will follow.

A high level paper giving guidelines on the CRD has been issued and this touches on Pillar 2 in the broader context.

LIBA

Katharine Seal introduced consideration of home-host issues.

Home-host is proving to be a priority issue for many firms in respect of Pillar 2. There is a danger that duplicate processes will need to be set up for firms that are part of a non-EU group.

A recent meeting with the Accord Implementation Group (AIG) was held on this issue, which identified a number of issues, and these were further discussed at a subsequent meeting hosted by LIBA. The common concerns were around the relationship between regulators; differences in the timetable between jurisdictions; consistency of approach between jurisdictions; proportionality; scope of group and sub-group; and uncertainty over what local regulations might expect vis-à-vis capital allocation.

These concerns and relevant questions will be confirmed to the FSA in writing so as to set in train a more detailed FSA/industry dialogue. The eventual aim would be to identify the key practical considerations which the FSA needs to build into its home/host framework and to form the basis of bilateral discussions with overseas supervisors and at firms' Basel 2 college meetings

At the meeting hosted by LIBA, Matthew Elderfield of the FSA had confirmed to participants that the regulators had identified anxieties over home-host as an important issue. As a result the AIG is trying to identify questions that are worrying firms (for instance on US-EU timetable difficulties or differences on the definition of default). The AIG is also planning to do more work on validation; the use test; and downturn LGDs.

Rosemary Hilary added that as a result of the meeting the debate had moved from a high-level to specific details being teased out.

BBA

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Kim Patel gave an overview of the BAA's position.

There were no plans to issue general guidelines. But firms were keen to get further clarification on specific areas.

A lot of the focus has been on smaller members. For these the BBA was contemplating the potential CEBS paper on small firms with a view to issuing guidelines. In addition a workshop had been held with a view to discussing what was involved in quantifying some of the risks.

BSA

Chris French outlined the main areas of interest for BSA members.

BSA members had many queries on Pillar 2 and ICAAP. Of particular interest was concentration risk which was viewed as being especially pertinent given the nature and legal restrictions on building societies.

Other relevant topics included interest rate risk and credit risk.

The BSA was aiming to address its members' queries soon.

6. **Agenda item 6: AOB**

Rosemary Hilary expressed interest in members' views on what more the FSA could do to engage the firms' board levels in Pillar 2. One member thought that board members had been starting to get involved over the previous few months.

Rosemary Hilary noted that holding the standing group on a Friday afternoon was not always a convenient time for all members. Friday mornings are not a workable alternative for the FSA but members were invited to put forward suggestions for other suitable days and times.

7. **Next meeting:** 21 April 2006