

## **Position of the European Financial Congress<sup>1</sup> in relation to the Basel Committee on Banking Supervision's consultative document on identification and management of step-in risk<sup>2</sup>**

### **Methodology for preparing the answers**

The answers were prepared in the following stages:

#### *Stage 1*

A group of experts from the Polish financial sector were invited to participate in the survey. They received selected extracts of the consultation document of the Basel Committee on Banking Supervision as well as consultation questions prepared by the European Financial Congress. The experts were guaranteed anonymity.

#### *Stage 2*

The survey project coordinators from the European Financial Congress prepared a draft synthesis of opinions submitted by individual experts. The draft was sent to the individual experts participating in the survey with the request to mark the passages that should be included in the final position as well as the passages they did not agree with or would like to be modified.

#### *Stage 3*

On the basis of the responses received, the final version of the European Financial Congress's answers was prepared.

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<sup>1</sup> European Financial Congress (EFC – [www.efcongress.com](http://www.efcongress.com)). The purpose of the regular debates held within the EFC is to ensure the financial security of the European Union and Poland.

<sup>2</sup> <https://www.bis.org/bcbs/publ/d398.pdf>

## Answers of the European Financial Congress

### **Question 1:**

**Is the scope of the definition presented in Section 2, which concerns the identification of risks and the scope of entities which may have a negative impact on the banking sector via the shadow banking market, appropriate? Should this group of entities be extended or, on the contrary, limited?**

In the opinion of EFC experts, the definition of risks and of the relevant entities is relatively broad but appropriate.

We suggest that the exclusion of mortgage banks from the category of institutions exposed to shadow banking and step-in risks be considered due to the special regulatory regime related to the activities of mortgage banks.

We also suggest that the scope of the definition related to step-in risk identification be supplemented with complex investment instruments offered to individual investors. Banks often offer to individual investors instruments of complex nature (structured products, bonds with specific characteristics, notes, etc.) whose internal workings the client does not fully understand. This exposes banks to significant indemnification risk in the event that in the future the investor is able to prove that not all characteristics of the instrument purchased were accurately presented to him or her.

### **Question 2:**

**Is the scope of comprehensive (Section 4.1) and targeted (Section 4.2) measures related to the identification, measurement and management of the risks associated with the banks' contacts with entities from the shadow banking market appropriate?**

The range of tools and measures is so broad and diverse that it enables banks to properly manage step-in risk.

However, the methods of identifying, measuring and managing step-in risk described are already in place at banks for individual types of risk (e.g. credit risk, liquidity risk). As a result, if the management procedures related to individual risk types are functioning properly, the step-in risk associated with contacts with shadow banking entities should in principle already have been taken into account at the level of e.g. credit policies or the liquidity ratios assumed.

Therefore, the scope of comprehensive measures presented in Section 4.1 of the consultation material is reasonable, but as concerns the proposed targeted measures (Section 4.2), we believe that there is no justification for introducing them into the set of current measures related to the banks' operations. Targeted measures related to step-in risk could, however, be successfully used in stress tests.

**Question 3:**

**Is the scope of banking policies and procedures for identifying and managing the risks associated with the banks' contacts with entities from the shadow banking market (Section 5.1) appropriate?**

The scope of requirements concerning risk identification and management policies and procedures appears appropriate.

It should be borne in mind, however, that the described elements of banking policies and procedures for identifying and managing the risks associated with the banks' contacts with shadow banking entities should already be part of lending, depository or treasury policies at banks that have robust risk management mechanisms in place.

Additionally, banks are already obliged to have crisis information policies in place within the framework of so-called recovery plans drawn up under the BRR Directive. Therefore, the changes envisaged in the consultation material will primarily concern identifying/drawing up the list of entities that meet the definition indicated in Section 2.1 of the consultation material.

In the case of smaller banks and banks with limited contacts with the shadow banking sector, the most difficult part of implementing the supervisory requirements related to step-in risk will be the quantification of this type of risk. In the EFC experts' opinion, the following steps should be taken:

1. roles/competences related to managing this type of risk should be defined more precisely, especially for smaller banks;
2. the approach to the quantification of this type of risk should be defined more precisely in order to be able to isolate the impact of this type of risk exclusively and to substantiate the values assumed – including when an analysis at the level of an individual shadow banking entity is required;
3. criteria for shadow banking entities should be defined so that the introduction of step-in risk requirements does not result in a risk to well-managed companies from the financial sector that are not subject to financial supervision by the state authorities designated for this purpose.