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### ***Prepared by:***

Secretariat of the European  
Banking Committee

### ***Contact:***

Tobias Mackie  
Secretary to the EBC  
Tel. +32 2 296 1661  
E-mail:  
[Tobias.Mackie@ec.europa.eu](mailto:Tobias.Mackie@ec.europa.eu)

## Capital Requirements Directive: Results of the Public Consultation

The Commission Services launched a [Public Consultation](#) on changes to Capital Requirements Directive on 16 April 2008. The comment period ran until 16 June 2008. The [responses](#) to this consultation provide a useful basis for the finalisation of the Commission's proposal. By 20<sup>th</sup> of June 2008, 122 responses had been received from various stakeholders, including associations and participants in the financial services sector. Responses were received from all but 8 Member States. These responses, along with the Commission Services' feedback to this consultation, will be published on the Commission Services' website, except in cases where confidentiality has been requested.

## Capital requirements Directive: Crisis Management, Colleges and Home/Host issues

In light of the results of the public consultation, the EBC discussed the following issues: i) determination of systemically relevant branches, ii) composition of colleges, iii) involvement of CEBS, iv) the role of the consolidating supervisor.

- Regarding the definition of systemically relevant branches, at its meeting on 20<sup>th</sup> June the EBC discussed the appropriateness of applying a 2% threshold in terms of deposits. This was based on a survey carried out by the Commission services, and could be part of a broader set of criteria.
- On the composition and functioning of colleges, the EBC considered the role of CEBS operational guidelines although some members were of the view that the Directive could be more specific. In particular, the proposal of industry representatives to refer to supervisors of third countries was considered.
- Member States discussed the degree to which CEBS should be referred to in the Directive to bring about convergence across colleges, but had mixed views regarding the role of CEBS in terms of mediation.
- In response to the concerns voiced by some industry representatives, the EBC discussed how to better increase the efficiency and effectiveness in colleges, bearing in mind that the draft proposal is not aiming to change the responsibilities of supervisors.



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## Capital requirements Directive: Large Exposures

The EBC discussed the alternatives for the treatment of large exposures. Industry's responses to the public consultation had been very supportive overall, since the suggested changes would simplify and harmonize current rules and thus reduce administrative burdens significantly. Industry also supported in particular the deletion of discretions in reporting, credit risk mitigation methods, and the exemptions list. The industry has made some requests for more general exemptions, such as exposures to entities within networks, clearing & settlement transactions, and state development banks.

Of most concern to industry, was the treatment of interbank exposures. According to the industry, treating interbank exposures as any other exposures would unduly restrict many banks' access to liquidity, especially in stress. Some responses have pleaded for exemptions of shorter maturities, while others argued for a higher limit or a combination of both. Many banks, however, do not oppose a back stop for interbank exposures, since they already apply stricter limits internally or collateralize as a rule. During the EBC meeting on 20<sup>th</sup> June, many Member States, on the other hand regarded a stricter treatment of interbank exposures as justified, in line with [CEBS advice](#). This issue will be considered further.

The suggested harmonized treatment of intra group exposures in the LE regime prompted a variety of responses from both industry and regulators, revealing a patchwork of national circumstances that justify national treatment. The ongoing work on cross border asset transferability had not yet provided sufficient clarity as to which harmonized treatment would be both feasible and sufficiently prudent. In this respect, there is a clear link to the Commission's work in the context of the [ECOFIN Council roadmap](#) on crisis management, aiming to identify and remove the obstacles to cross border asset-transferability.

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## Capital requirements Directive: Liquidity Risk Management

The Commission services had already began work on liquidity risk management before the current financial crisis, and was at pains to stress the importance of complementing the Basel II/CRD framework with an appropriate regulatory response.

The market crisis has highlighted the need for firms to develop strong liquidity risk management practise, due to the interaction between market and funding liquidity risk, and of collateral management, including on an intra-day basis, as well as the existence of legal, regulatory and operational constraints.

Both the Ecofin and the FSF/G7 recommendations confirm the need to develop appropriate regulatory responses by strengthening firms' liquidity risk management.

On June 17, both the [Basel Committee](#) and [CEBS](#) (with the latter responding to the call for advice issued by the European Commission in March 2007) published draft principles for firms and supervisors.



The EBC agreed to transpose this work into the CRD through Comitology before the end of 2008 by clarifying the existing provisions. At its meeting on 20<sup>th</sup> June, the EBC noted that the proposed changes to the CRD published by the European Commission for consultation on April 16, should improve supervisory cooperation and information sharing among public authorities involved in overseeing firms' liquidity risk management.

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## Capital requirements Directive: Hybrid Capital Instruments

Current market developments have confirmed the importance of hybrid instruments as an important funding source for banks. The additional deterioration in economic performance by the banking sector during 2008 has however confirmed that during a severe crisis, equity capital represents the true "first line of defence".

In that context, the EBC, at its meeting on 20<sup>th</sup> June, discussed the proposal made by the European Commission, in particular on the three main differences from [CEBS' advice](#) dated 28<sup>th</sup> March 2008 (definition of hybrids, possible recognition of dated instruments and quantitative limits) and the preliminary feedback received during the consultation. (The issue of dated instruments was the main controversial issue raised by most members).

The EBC agreed on the need for CEBS to carry out additional work after the approval of the CRD final text in order to align its advice to the new Directive.

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## Capital requirements Directive: Securitisation

The consultative document published on April 16<sup>th</sup> by the Commission Services contained a limited number of draft changes to the CRD in the securitisation field about lessons from the subprime crisis. These draft changes are fully consistent with the issues identified by the ECOFIN Council in its roadmap for drawing lessons from the crisis. The draft changes aim at:

1. enhancing the risk management practices of banks when acting as investors, sponsors or originators;
2. adjusting specific shortcomings of the provisions capital requirements for securitisation position and;
3. addressing concerns about the incentives for lending banks to act prudently when granting loans, even when the credit risk of the loans is in the end borne by investors in securitisations rather than by the lending bank itself.

The EBC, at its meeting on 20<sup>th</sup> June, discussed the preliminary feedback from the public consultation on these draft proposals. In particular, the EBC devoted attention to the incentives in the securitisation process.





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## Capital requirements Directive: Process for the CRD amendments

The Commission plans to put forward amendments to the CRD through different legislative instruments:

- One proposal for a Council and European Parliament Directive under the "co-decision" procedure. This will cover crisis management/colleges, large exposures, hybrids, minimum capital for securitisation, waivers for banks affiliated to a central institution.
- Two implementing Directives to be adopted by the Commission under the "comitology" procedure (covering technical amendments to the Directives Annexes): one amending Directive 2006/48 and the other Directive 2006/49.

The Commission intends to put these texts forward for adoption in early autumn 2008. With regard to the *Comitology* texts, these will be presented for approval by vote to the European Banking Committee in September 2008 and thereafter will be submitted for scrutiny to the European Parliament; the intention of the Commission is to adopt the Comitology provisions by January 2009. With regard to the *Co-decision proposal*, following formal adoption by the Commission in September 2008, the Commission's proposal will be considered by the European Parliament and the Council of Ministers. It is expected that this legislative process can be completed by spring 2009.

## Deposit Guarantee Schemes: lessons from the current turmoil and policy implications

In a paper submitted to the EBC meeting on 20<sup>th</sup> June, the Commission services considered the policy implications of the current turmoil for deposit guarantee schemes. The discussions at the EBC were intended to gather comments which should assist the Commission in its preparation of a policy paper to be submitted to the EFC in September.

In its paper the Commission services have drawn both on the first results of the work initiated further to the [Communication](#) of Autumn 2006 as well as on recent experience during the financial turmoil, in order to identify a number of key issues which merit the special attention of policy makers:

- The time it takes to pay out to depositors in the event of failure is too long, and is an important factor in undermining depositor confidence. Available evidence on actual payout delays (the Directive imposes a maximum period of 3 months) suggests only 70% of depositors received their money within that period. However tackling the underlying causes which lead to delays in payout would be a pre-requisite to considering any further reduction of the amount of time allowed for payout in the Directive.
- Wide discrepancies in coverage levels may not be conducive to efficient cross-border payouts in the EU, and recent experience has called into question the continued application of so-called "co-insurance" rules, whereby Member States may allocate up to 10% of the loss to be borne by depositors themselves.
- Although the Directive requires "comprehensible information" about coverage levels of DGS, further enhancements appear necessary in light of the recent turmoil: clear recommendations are expected from the European Forum of Deposit Insurers', who are preparing a report on this subject.



- A report by the Commission's Joint Research Centre (see below) has found strong disparities between schemes with regard to their capacity to pay out to depositors in certain types of bank failure. However not even the strongest ex ante funded scheme would be able to draw on sufficient funds to cope with a large cross-border failure.

The Commission services have concluded that, while work is necessary to strengthen existing schemes, in light of the obvious limitations to the effectiveness of DGS to deal with large cross-border bank failures, additional work needs urgently to be undertaken in order to address differences and gaps which may exist in the area of early intervention tools for supervisors and which may complicate efficient cross-border crisis handling. The Commission therefore proposes to conduct further urgent work, giving consideration to assessing the respective merits of a range of early intervention powers in a cross-border context.

However, in order to enhance confidence in the functioning of schemes and to improve their efficiency, the Commission will consider proposing that the following three issues be tackled by an amendment of the current Directive:

- Reduction of payout delays
- Abolition of co-insurance
- Further convergence towards a uniform coverage level

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## Deposit Guarantee Schemes: publication of reports on efficiency and risk-based contributions, and further non-regulatory initiatives

The Commission services have published two reports which provide important background analysis aimed at feeding into the Commission's ongoing review of the Deposit Guarantee Schemes Directive:

- the report on [Efficiency of Deposit Guarantee Schemes](#) investigates the financial resources available to EU Deposit Guarantee Schemes (both ex-ante or ex-post funded), with a view to assessing the robustness of schemes in Member States (with the exception of Germany) and Norway. For this purpose, several scenarios have been developed on the basis of real crises in the past, ranging from a small domestic failure to the failure of a large cross-border credit institution. The research has found different levels of robustness between schemes, although indicates that the majority would be able to deal with a medium-sized bank failure. After a brief analysis of payout delays (more substantial work on this issue will be delivered by EFDI), the main features of the US deposit guarantee system are described and compared with the EU schemes. The report also contains annexes which update key figures of the 2007 report on the funding of schemes and provides an overview about the internal procedures which schemes have to follow in order to make payouts.
- The report on [risk-based adjustments to contributions](#) that banks have to pay to schemes, is part of the non-legislative work proposed by the Commission in its 2006 Communication. The aim of the report is to describe the current approaches in different schemes to fix the level of contributions paid by members. On the basis of these results, the European Forum of Deposit Insurers (EFDI) and JRC are aiming to develop voluntary recommendations for those schemes that may wish to introduce such adjustments. The report also provides information about the US approach.



The Commission is awaiting findings from EFDI on four non-legislative elements stemming from the Commission's Communication of 2006:

- obstacles for a rapid payout to depositors,
- best practice for the information of depositors about their protection
- the appropriateness of the current definition and scope of the Directive
- possible information deficits between DGS and other entities.

The results of work on the remaining self-regulatory issues (topping up arrangements between DGS and risk-based contributions of banks to DGS, see above) are due in 2009. A draft Memorandum of Understanding on topping up is being discussed within EFDI.

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## Lamfalussy: Commission Opens Consultation possible changes to its decisions establishing Level 3 Committees

Further to the publication of the Commission's Communication on the review of the Lamfalussy process, the responsibilities of Level 3 Committees to foster supervisory convergence and cooperation have been the subject of some intense discussions.

The [ECOFIN Council of 14 May](#) reflected a broad consensus between most parties that the responsibilities of the Level 3 Committees should be aligned, clarified and strengthened in order to ensure an enhanced contribution to supervisory cooperation and convergence at EU level and the safeguarding of financial stability.

On 23<sup>rd</sup> May, the Commission services launched a [public consultation](#) on possible amendments to its decisions establishing Level 3 Committees. In particular, the Commission services have proposed that the Decisions establishing CESR, CEBS and CEIOPS should explicitly refer to the main tasks that the Level 3 Committees are expected to perform. The Commission services have also suggested that they could in particular be responsible for: mediating between supervisory authorities; ensuring adequate information exchange between supervisors; streamlining reporting requirements; elaborating common guidelines for the operation of colleges; fostering delegation of tasks and responsibilities; developing a common European supervisory culture and ensuring efficient cross-sectoral cooperation with other Level 3 committees. With regard to financial stability the Commission services suggest entrusting the Level 3 Committees with responsibilities to provide regular, up-to-date, focussed and forward-looking reporting to Finance ministers and ensuring proper translation of risk analysis into policy action.

A public consultation is open until 18 July.