



European Banking Committee

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## European Banking News

EU newsletter for the European Banking Committee

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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)

## European Banking Committee votes to amend the Capital Requirements Directive (Comitology)

On September 24<sup>th</sup>, a draft set of amendments to the Capital Requirements Directive was submitted to the formal opinion of the EBC. This set of amendments has been presented in accordance with the European Banking Committee's [Comitology](#)<sup>i</sup> powers – which allow faster adoption of certain technical changes to the Directive.

There are in fact two draft Commission directives covering technical amendments to the CRD Annexes: one amending [Directive 2006/48/EC](#) and the other [Directive 2006/49/EC](#).

The EBC voted in favour of approving the draft amendments. The next step in the comitology procedure is the scrutiny by the European Parliament and the Council. These two institutions have three months to examine the draft amendments and express their opinion. If neither the EP nor the Council opposes the adoption by the Commission of the proposed amendments, the Commission will adopt the comitology amendments in January 2009.

## Commission proposes revision of bank capital requirements rules to reinforce financial stability

On 1<sup>st</sup> October, the European Commission proposed a [revision of the capital requirements Directive](#) through co-decision<sup>ii</sup> procedure. The new Directive aims to update EU rules on capital requirements for banks designed to reinforce the stability of the financial system, reduce risk exposure and improve supervision of banks that operate in more than one EU country. Under the new rules, banks will be restricted from lending beyond a certain limit to any one party, while national supervisory authorities will have a better overview of the activities of cross-border banking groups. The proposal, which amends the existing Capital Requirements Directives, reflects extensive consultation with international partners, Member States and industry. It now passes to the European Parliament and the Council of Ministers for consideration.

The main changes proposed are as follows:

- **Improving the management of large exposures:** banks will be restricted from lending beyond a certain limit (€150 million or 25% of own funds, whichever is higher) to any one party. As a result, in the inter-bank market, banks will not be able to lend or place money with other banks beyond a certain amount, while borrowing banks will effectively be restricted in how much and from whom they can borrow.
- **Improving supervision of cross-border banking groups:** 'colleges of supervisors' will be established for banking groups



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that operate in multiple EU countries. The rights and responsibilities of the respective national supervisory authorities will be made clearer and their cooperation will become more effective.

- **Improving the quality of banks' capital:** there will be clear EU-wide criteria for assessing whether 'hybrid' capital, i.e. including both equity and debt, is eligible to be counted as part of a bank's overall capital – the amount of which determines how much the bank can lend.
- **Improving liquidity risk management:** for banking groups that operate in multiple EU countries, their liquidity risk management – i.e. how they fund their operations on a day-to-day basis – will also be discussed and coordinated within 'colleges of supervisors'. These provisions reflect the on-going work at the Basel Committee on Banking Supervision and the Committee of European Banking Supervisors.
- **Improving risk management for securitised products:** rules on securitised debt – the repayment of which depends on the performance of a dedicated pool of loans – will be tightened. Firms (known as 'originators') that re-package loans into tradable securities will be required to retain some risk exposure to these securities, while firms that invest in the securities will be allowed to make their decisions only after conducting comprehensive due diligence. If they fail to do so, they will be subject to heavy capital penalties

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## Further possible regulatory developments

Over the past two years, the [Capital Requirements Directive Transposition Group](#)<sup>iii</sup> (CRDTG), through an open and transparent consultation process with Member States and market players, has been instrumental in identifying shortcomings to the existing rules and proposing refinements which have been included in the Commission's Comitology texts. The next CRDTG meeting will take place on 27th of October. It will examine i) how to resolve a number of remaining unanswered CRDTG questions, ii) possible additional technical changes based on the CRDTG work that have not yet been discussed as part of the preparation of the comitology text, iii) options and national discretions on the CRD further to CEBS' call for technical advice due by mid-October, iv) the outcome of Commission services' consultation on the treatment of incremental risk in the trading book (running until 15 October), and v) the latest development in Basel regarding securitisation.

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## Commission consults on Credit Rating Agencies

Over the summer, the Commission services conducted a [public consultation](#)<sup>iv</sup> on a draft legislative proposal on credit rating agencies. Numerous responses were received and DG Internal Market is currently carefully reviewing these. The legislative proposal will feature a legally binding registration and external oversight regime to enable European regulators to supervise the policies and procedures followed by credit rating agencies. This regime will cover aspects such as conflicts of interest, duty of vigilance by credit rating agencies on the quality of their rating methodologies and the ratings they give and transparency. Careful consideration is also being given to the interaction between these proposed rules and the recognition of external credit assessment institutions ("ECAIs") for the purposes of calculating the CRD credit risk capital requirements. The intention is to table a formal Commission legislative proposal this autumn.



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## Commission reviews regulatory treatment of Commodities

According to both the MiFID and the CRD, the Commission is required to review the regulatory treatment of specialist firms trading or providing investment services in commodity and exotic derivatives, both from a business conduct and prudential point of view.

This review is currently underway and covers in particular the merits of continuing, amending or discontinuing the various exemptions granted to specialist firms once an appropriate regulatory treatment of investment services related to these products has been identified.

The Commission has requested [joint advice](#) from CEBS and CESR, which is expected to be delivered in the first half of October. The review will culminate in a report from the Commission to Parliament and Council, planned by the end of this year.

## Deposit Guarantee Schemes: Commission accelerates revision of the Directive

Events in 2007 and in 2008, and in particular the current turmoil on the financial markets, have exposed a number of deficiencies in the existing European framework for Deposit Guarantee schemes which have impacted depositors' confidence.

Crucially, as a consequence of the uncertainties caused by the turmoil, depositors are increasingly aware of the extent to which their deposits are or are not protected. There is increasing concern among many savers that they may not be fully reimbursed in the event of a bank failure because their savings exceed the coverage levels in their country, and that should their bank fail, there may be lengthy delays before they are able to regain access to their funds.

The minimum coverage level of €20.000 has not been adjusted since 1994 and is no longer adequate, especially in countries where a considerable proportion of the population hold savings in excess of the minimum coverage level. Recent evidence suggests that the competitive distortions created by different national measures are having a real and disturbing impact on deposit taking.

The Council of the European Union agreed on 7 October 2008, that it is a priority is to restore confidence and proper functioning of the financial sector and committed to taking all necessary measures to protect the deposits of individual savers. In particular, the Council welcomed the Commission's intention to bring forward urgently an appropriate proposal to promote convergence of deposit guarantee schemes. The Commission is currently in the process of rapidly adopting a proposal which will revise the existing Directive in three key areas:

- Increase of the minimum coverage level initially to €50 000 and after one year to €100 000
- Reduction of the payout delay to a maximum of 3 days
- Termination of co-insurance

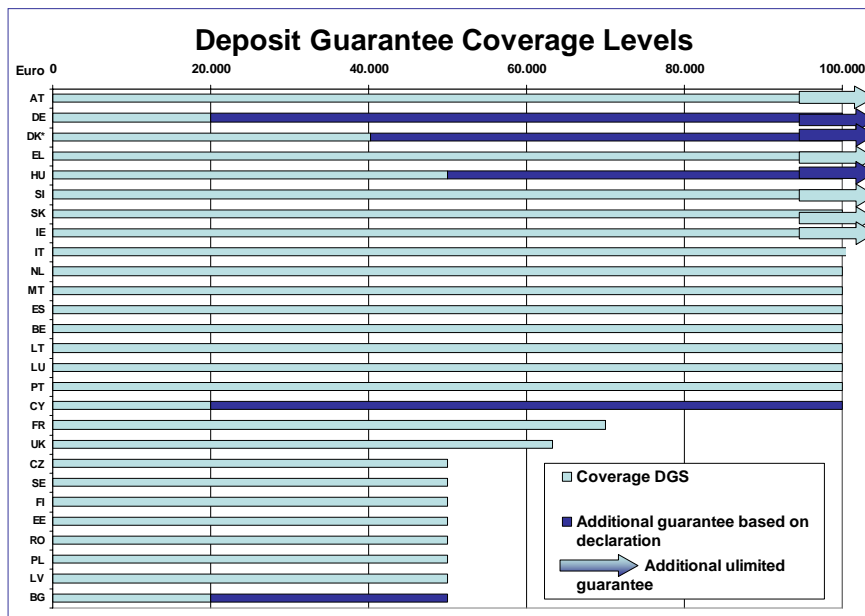
The Commission adopted the [proposal](#) on 15<sup>th</sup> October and with the support of Member States and the EP to proceed with rapid agreement transposition can be in place by the end of this year.

In the meantime, Member States are already in taking measures to raise the guarantee level of schemes in their own Member States. The following chart summarises the latest state of play:





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\* Additional coverage applies to banks participating in the Private Contingency Association

## Deposit Guarantee Schemes: work underway by EFDI

The Commission's 2006 Communication advocated a number of improvements to schemes through non-legislative initiatives. The Commission has recently received draft reports from EFDI<sup>v</sup> on the following issues:

- 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) are due in 2009.

The Commission's Joint Research Centre has also recently published reports on [efficiency of schemes](#) and [risk-based contributions](#) to schemes, which have been described in detail in the previous newsletter.

## Commission preparing report on Procyclicality of the Capital Requirements Directive

In the wake of continuing instability in the financial markets and the onset of the worldwide economic slowdown, concerns have been expressed about potentially "procyclical" effects of the Basel II framework. This issue has moved to the forefront of agendas of international forums such as G7/FSF and the BCBS and was raised at the informal ECOFIN meeting in Nice in September 2008.

Procyclicality is a feature of the financial system that, by way of mutually reinforcing mechanisms, amplifies natural fluctuations in the economic cycle. It is widely accepted that bank lending follows the



same cyclical pattern as that of the real economy: lending growth is strong in an economic upturn but slow or contracting in a recession. The ensuing variation of credit supply impacts aggregate demand for goods and services and, hence, exacerbates the economic cycle. A certain degree of procyclicality is inherent in the financial system and is explained, for example, by information asymmetries and behavioural finance theories. However, it may be further influenced by capital regulation and other factors. If found to be material, procyclicality is a source of concern for policymakers due to its implications for the economic stability.

The CRD came into full effect in 2008 and analytical work on its procyclical effects is underway. The report of the European Commission will be informed by, among others, the findings of a joint Task Force on the Impact of the new Capital Framework (TFICF) that has been set up by the ECB and the Committee of European Banking Supervisors (CEBS). The work of the TFICF comprises:

- identifying the underlying determinants and monitoring the impact of macroeconomic conditions on the cyclicity of capital requirements;
- analyzing how any volatility in capital requirements is transmitted to the lending and pricing decisions; and
- assessing the impact of bank behaviour on the economic activity to determine whether the CRD has a significant effect on the economic cycle.

The European Commission will be closely following how the work undertaken in the various forums is progressing in order to feed into its own analysis and determine whether any remedial measures are warranted. Article 156 of the CRD requires that the European Commission, in collaboration with the European Central Bank (ECB), monitors and assesses the materiality of any procyclical implications of the legislation in a biennial report to be submitted to the European Parliament and the Council. The first report will be presented at the end of 2009.

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## Ongoing work to review Winding-up rules

In July 2008, the external consultant, DBB Law, began work to review the Directive on the reorganisation and winding up for credit institutions and on barriers of asset transfers within cross border banking groups. In the first phase of the project the focus is on asset transferability. The consultant and its international network of experts in more than 16 Member States are working to identify any barriers to asset transferability and to elaborate solutions about these might be reduced in crisis situations. The interim report is expected to be delivered by early November, which will feed into a feasibility study on asset transferability which is due to be submitted to the Economic and Finance Committee (EFC).

The second part of the project will deal with insolvency issues. The reorganisation and winding up of cross-border groups is still nationally based which might give rise to suboptimal outcomes in cases where more than one Member State is involved in a bank failure. The consultant will identify different solutions about how to implement a more efficient crisis resolution framework in the EU for cross border banks. The final report is expected by March 2009.

This work should provide valuable input into the work on the White Paper on Early intervention tools for dealing with ailing banks.

## Commission plans to publish White Paper on Early Intervention tools for dealing with ailing banks

On 14 May, the ECOFIN Council requested the European Commission to examine *"the possible link to early intervention and reorganisation of a financial group, as well as issues related to the sharing of a financial burden"*. At the last European Banking Committee meeting, the Commission outlined its plans for a White Paper on Early Intervention to deal with ailing banks as a means of enhancing crisis handling.

Early intervention tools relate to all pre-liquidation stabilisation measures aimed achieving timely solutions for an ailing bank at the lowest possible cost to the public purse while at the same time ensuring the continuity of activities and confidence of depositors. This includes suspension of payment of dividends, transferring or selling assets/liabilities to a healthy bank outside the group, taking over the management and assets of a bank, appointing a special administrator, setting up a bridge bank, creating a new bank or merging the bank with another bank, temporary public ownership, etc.....

The main focus of the White Paper will be on assessing whether the current range of crisis prevention/resolution/stabilisation tools available to authorities can and should be complemented by additional tools and whether there is a case for further convergence of such tools at EU level. The Commission will also consider the appropriateness of tools for dealing with both cross-border and domestic institutions.

The Commission has already requested CEBS to undertake a stocktake of supervisory powers, as well as the trigger events or conditions which govern the use of crisis management tools. The Commission is also setting up a special Member State working group to help it formulate policy options, and is planning to launch a public consultation in early 2009. Publication of the White Paper is planned for mid 2009.

<sup>i</sup> [http://europa.eu/scadplus/glossary/comitology\\_en.htm](http://europa.eu/scadplus/glossary/comitology_en.htm)

<sup>ii</sup> [http://europa.eu/scadplus/glossary/codecision\\_procedure\\_en.htm](http://europa.eu/scadplus/glossary/codecision_procedure_en.htm)

<sup>iii</sup> [http://ec.europa.eu/internal\\_market/bank/regcapital/transposition\\_en.htm](http://ec.europa.eu/internal_market/bank/regcapital/transposition_en.htm)

<sup>iv</sup> [http://ec.europa.eu/internal\\_market/consultations/2008/securities\\_agencies\\_en.htm](http://ec.europa.eu/internal_market/consultations/2008/securities_agencies_en.htm)

<sup>v</sup> European Forum of Deposit Insurers