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The Committee of European
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Consultation paper on technical advice to the European Commission on options and national discretions – CP18

Dear Madam, dear Sir,

On 22 May 2008 CEBS published consultation paper CP18 with recommendations on how to deal with the options and national discretions in the Capital Requirements Directive (CRD) and invited comments by 15 August 2008. We welcome the opportunity to respond to the paper and set out below the comments of the German banking industry.

General remarks

Before commenting in detail on the suggested changes to national discretions and options, we would like to make a few general points.

We warmly welcome the work undertaken by CEBS on reducing the number of options and national discretions contained in Directives 2006/48/EC and 2006/49/EC. Further harmonisation of supervisory requirements is an important prerequisite for creating a true European single market. Consistent requirements throughout Europe would reduce competitive distortions and also cut costs for banks operating across borders.

We particularly welcome the proposed use of joint assessments. This is an approach which we believe will promote cooperation between European supervisors and advance the convergence of supervisory practices.

Moreover, in our view, joint assessment processes would also lend themselves to areas other than those considered in CP18. One example is the categorisation of central counterparties whose transactions are full collateralised on a daily basis (Annex III, Part 1, point 2 in conjunction with Article 78(4) of Directive 2006/48/EC). If the eligibility of entities as central counterparties within the meaning of the CRD were examined by CEBS in a uniform manner throughout the EU along the lines of the procedure for recognising external credit assessment institutions (ECAIs), we believe this would bring about further convergence of supervisory practices. On top of this, the joint assessments would make the assessment process considerably less onerous for both European banks and national supervisors. We would also like to suggest conducting joint assessment processes to determine whether third countries have supervisory regimes which are substantially equivalent to the arrangements in Directives 2006/48/EC and 2006/49/EC and whether regional governments and local authorities in these countries are treated by their supervisors in the same manner as central governments (e.g. Annex VI, Part 1, point 11 of Directive 2006/48/EC).

Where national discretions are justified by the need to take account of local market conditions, we suggest that mutual recognition should always be binding. In other words, the decision of one national competent authority should be applied in a binding manner by all competent authorities to loans granted in this market by banks from other member states. Such mutual recognition should at least be binding where decisions by national competent authorities in the EU are concerned. This is the only way to avoid competitive distortion. If there is an information gap between competent authorities, which CEBS cites as an argument for non-binding mutual recognition, this should be bridged by greater cooperation and communication between supervisors in the context of supervisory disclosure.

The rationale behind the proposed conversion of national discretions into supervisory decisions “to be used on a case by case basis” is not sufficiently clear in our view. We believe that provisions whose application is conditional on satisfying objective criteria should be made available for use by all European banks which fulfil the criteria in question. It is naturally then up to national supervisors to verify such compliance case by case.

We take the view that the paper's recommendations on changing national discretions are a step in the right direction. There are nevertheless some points where we feel that an alternative solution would be more appropriate and more effective in bringing about consistent supervisory practices in Europe. We would also refer you in this context to the proposals for revising options and national discretions in our ZKA response of 15 October 2007 to the questionnaire published by CEBS on this issue.

We will now address those changes proposed by CEBS which we consider especially relevant.[1]

Specific comments

2. Own Funds, Article 58

This enables competent authorities to allow the banks in their jurisdiction not to deduct shares held in another entity for restructuring purposes. We believe all European banks should be able to apply this provision if they satisfy the necessary criteria. There is no reason, in our view, why banks meeting the conditions for using the provision should not all be treated in the same way.

We therefore propose that CEBS should either recommend a **general rule** or clarify in its advice that banks may refrain from deducting the shares if they satisfy the relevant criteria.

3. Own Funds, Article 59

Under this national discretion member states can permit banks to use methodologies for calculating regulatory capital set out in the Financial Conglomerates Directive instead of deducting certain participations. CEBS proposes amending the wording of the provision to reflect that of the Conglomerates Directive and transforming the discretion into a supervisory decision. Although we understand the arguments put forward by CEBS in favour of a supervisory decision, we believe that every bank should be free to choose the methodology most

[1] We have once again refrained from commenting on discretions 9 through to 11.

suitable for its needs. This is the only way to take adequate account of the bank's corporate structure.

We consequently consider the reference to the consolidating supervisor unnecessary and suggest amending the wording as follows:

> *As an alternative to the deduction of the items referred to* in points (o) and (p) of Article 57, *Member States shall allow ~~their competent authorities, where they assume the role of consolidating supervisor with regard to a particular banking group, to decide, after consultation with the other relevant competent authorities and the~~ banking groups ~~itself~~, to apply mutatis mutandis methods 1, 2 or 3 of Annex I to Directive 2002/87/EC. Method 1 (accounting consolidation) may be applied only if the competent authority is confident about […].*

12. Scope of Application, Article 72.3

We reject a supervisory decision for exempting banks belonging to a group from disclosure requirements if their parent company provides comparable information about them on a consolidated basis. Processing the data necessary to comply with the disclosure requirements is highly onerous for the banks and out of all proportion to the associated benefits. For market participants, group-level disclosure provides a more relevant basis on which to evaluate a bank's economic situation than separate disclosure by each individual member of the group. This discretion should therefore be changed into a **general rule**.

13. Scope of Application, Article 73.1

To promote the convergence of supervisory practices, it should be made clear that supervisory authorities need to agree on a common, pan-European interpretation of the criteria for deciding whether or not to include a bank belonging to a group in the scope of consolidation.

14. Scope of Application, Articles 22, 24 and 25 (Directive 2006/49/EC)

To ensure consistent supervisory practices, it should be clarified that supervisors need to base their decisions on exempting entities from the application of consolidated capital requirements on a common, pan-European interpretation of the relevant criteria.

15. Counterparty Risk in Derivatives, Annex III, Part 3

In our opinion, all banks satisfying the mentioned requirements should be allowed to choose their method of calculating future potential credit risk.

We therefore suggest changing the discretion into an **option for institutions**.

16. Counterparty Risk in Derivatives, Annex III, Part 6, point 7

When designing their internal models, banks set alpha on the basis of their evaluation of risk. The suitability of an internal model and its underlying assumptions should be assessed by supervisors in the overall context of the supervisory approval process. It would not, in our view, be appropriate to single out alpha for separate assessment. We therefore welcome CEBS's drafting proposal.

17. Counterparty Risk in Derivatives, Annex III, Part 6, point 12

Supervisory authorities analyse the suitability of the alpha estimate as part of their supervisory approval process of an internal model. Our understanding is that it is up to the banks to decide whether or not they wish to use an internal estimate of alpha in their internal model. We believe the wording of this provision needs to express this intention more clearly.

18. Counterparty Risk in Derivatives, Annex III, Part 7c (ii)

In our opinion, each bank should be able to decide itself on the most appropriate method of calculating the net-to-gross ratio. This decision can then be challenged competent authorities if necessary in the context of their ongoing supervision. We therefore advocate changing this national discretion into an **option for institutions**. Should reservations exist concerning an option for institutions, we would suggest making alternative (i), i.e. separate calculation of the net-to-gross ratio, a general rule.

19. Standardised Approach, Article 80.3 & Annex VI, Part 1, point 24

To ensure a level playing field, the same risk weights should be applied to the same exposures in all member states. In the absence of external ratings for most European banks at present, we are in favour of making option (a) a **general rule**. It should also be borne in mind that various other risk weights may be derived from the risk weight selected for institutions (e.g. for regional governments, local authorities, covered bonds, etc.). The national discretion concerning risk weights for institutions therefore leads to far-reaching discrepancies within Europe in the risk weights assigned to identical exposures.

20. and 21. Standardised Approach, Article 80.7 and 80.8

In the interests of consistent supervisory practices in Europe, we welcome CEBS's proposals on zero weighting for intra-group exposures and exposures between institutions belonging to the same institutional protection scheme.

22. Standardised Approach, Article 83.2

We believe that the quality of unsolicited ratings should be subject to joint assessment by competent authorities along the lines of the procedure for recognising ECAIs for risk weighting purposes. The result of the joint assessment should be binding on all national supervisors. If it does not prove possible to come to a joint decision in the short term on the use of unsolicited ratings, we agree with the proposed supervisory decision. Supervisors should nevertheless agree on a common approach to using unsolicited ratings in the longer term.

23. Standardised Approach, Annex VI, Part 1, point 5

This national discretion allows exposures to central governments and central banks in third countries to be assigned a reduced risk weight, i.e. that applied by an "equivalent" competent authority in the third country in question. We welcome the recommended joint assessment process. To achieve the desired harmonisation of supervisory practices, however, the result of the joint assessment should be binding on all supervisors.

We consequently advocate **binding mutual recognition**. We also recommend conducting the planned joint assessment processes in the near future.

24. Standardised Approach, Annex VI, Part 1, point 11

Under this national discretion, exposures to regional governments and local authorities in a third country can be treated in the same way as exposures to the country's central government if this is also the procedure applied by an "equivalent" competent authority in the country in question. We welcome the recommended joint assessment of material equivalence. To achieve the desired harmonisation of supervisory practices, however, the result of the joint assessment should be binding on all supervisors.

We therefore advocate **binding mutual recognition**. In addition, the joint assessment process should apply not only to the equivalence of a third country's supervisory regime, but also to the designation of those regional governments and local authorities in the third country which receive the same treatment by their supervisors as does its central government.

26. Standardised Approach, Annex VI, Part 1, point 15

We welcome CEBS's proposal that a list should be published of the public-sector entities assigned the same risk weight as that for central governments or of the criteria for assigning this risk weight. This would significantly reduce the amount of time and effort European banks and national supervisors currently have to invest in checking this information.

27. Standardised Approach, Annex VI, Part 1, point 17

Under this national discretion, exposures to public-sector entities in a third country can be treated in the same way as exposures to institutions in that country if this is also the procedure applied in the country in question and if that country has an “equivalent” supervisory regime. We welcome the recommended joint assessment process. To achieve the desired harmonisation of supervisory practices, however, the result of the joint assessment should be binding on all supervisors.

We therefore advocate **binding mutual recognition**. In addition, the joint assessment process should apply not only to the equivalence of a third country’s supervisory regime, but also to the designation of those public-sector entities in the third country which receive the same treatment as institutions by their supervisors.

30. Standardised Approach, Annex VI, Part 1, point 63

This allows competent authorities to assign a 100% risk weight to past due exposures secured by types of collateral other than those eligible for credit risk mitigation purposes. Although we would prefer a **general rule**, deletion of this national discretion after a long transitional period (until the end of 2019) would be acceptable.

31. Standardised Approach, Annex VI, Part 1, point 64

Competent authorities can permit past due exposures secured by residential property to be assigned a reduced risk weight if value adjustments are at least 20%. We do not consider it appropriate to drop this national discretion because the risk associated with the exposure is reduced by the risk provisioning and by the existence of valuable security. We are therefore in favour of **binding mutual recognition**. In mature markets, a detailed valuation of the residential property in question can made. In our view, the valuable nature of the security and the ability to calculate precisely how much could be realised from a sale reduce the risk of loans secured by residential property in mature markets. This should be reflected by assigning a lower risk weight.

33. Standardised Approach, Annex VI, Part 1, point 67

Under this national discretion competent authorities may permit reduced risk weights to be assigned to high-risk non-past due exposures for which value adjustments have been made. We do not consider it appropriate to delete this discretion because these risk provisioning measures effectively lower the risk of the exposure.

We advocate **binding mutual recognition**.

34. Standardised Approach, Annex VI, Part 1, point 68 (e)

We do not consider it appropriate to raise the loan-to-value ratio of loans secured by commercial property from 60% to 70%. As CEBS correctly points out, the majority of member states do not exercise this discretion. To avoid competitive distortion, this national discretion **should be dropped**.

37. IRB, Article 84.2

Banking groups which apply the IRB approach in a unified manner may be allowed by their competent authorities to demonstrate compliance with minimum capital requirements on a consolidated basis. CEBS would like to retain the rule unchanged. We believe all European banks should have the right to apply this rule provided that they satisfy the relevant condition. It is the responsibility of supervisors to verify that this is the case.

This interpretation of the rule is not ensured by the present wording of Article 84.2.

38. IRB, Annex VII, Part 1, point 6

Different ways of exercising this discretion concerning lower risk weights for SL exposures have resulted in considerable competitive distortion. We agree with CEBS's view that the risk weights for SL exposures should be evaluated as part of the overall IRB approval process. If a level playing field is to be created, however, competent authorities should agree on a single set of criteria for permitting more favourable treatment of SL exposures and apply these criteria to all European banks.

41. IRB, Annex VII, Part 2, points 5 and 7 & Annex VIII, Part 1, point 26

This allows competent authorities to recognise certain credit protection providers for dilution risk which would not normally be eligible for risk mitigation. CEBS proposes dropping this national discretion. We are in favour of retaining it and making it mandatory for competent authorities to recognise each others' decisions (**binding mutual recognition**).

43. IRB, Annex VII, Part 2, point 15

Competent authorities may permit banks to replace the explicit maturity adjustment of the advance IRB approach with the M of the foundation IRB approach (2.5 or 0.5 years) for exposures to companies with consolidated assets and consolidated sale of less than €500m. CEBS would like this national discretion to be dropped after a transitional period of ten years. Existing rules on the use of M would then continue to apply to loans granted before the expiry of this period (grandfathering).

We strongly recommend that this national discretion be retained. Deletion would have unforeseeable consequences for the long-term funding of SMEs in Germany. According to estimates by Deutsche Bundesbank, the 14 banks using the advanced IRB approach in Germany already cover around 45% of total risk-weighted exposure amounts. This figure is expected to rise even further in future.

Furthermore, we would like to point out that this national discretion is part of the so-called "SME compromise" reached by the Basel Committee on 21 July 2002. It is based on a resolution passed by the Finance Committee of the German Bundestag and the German delegation would, if necessary, have allowed negotiations on Basel II to fail on this point. Deletion could consequently have serious political implications and an adverse effect on the further convergence of supervisory law in the EU.

. . .

<u>44. IRB, Annex VII, Part 2, point 15 (last sentence)</u>

CEBS also recommends dropping this national discretion after a ten-year transitional period. We are in favour of retaining it for the same reasons as those outline above in connection with no. 43. The scale of investment required by real estate companies justifies the higher threshold for exemption from explicit maturity adjustment rules.

<u>45. IRB, Annex VII, Part 2, point 20 & Annex VIII, Part 1, point 26</u>

This national discretion allows competent authorities to recognise certain credit protection providers for dilution risk which would not normally be eligible for risk mitigation. CEBS proposes dropping this national discretion. We are in favour of retaining it and making it mandatory for competent authorities to recognise each others' decisions (**binding mutual recognition**).

<u>49. Credit Risk Mitigation, Annex VIII, Part 1, point 21</u>

We believe that, if the desired harmonisation of supervisory practices is to be achieved, a competent authority's decision on the eligibility of physical collateral should be binding on all other national supervisors in the EU.

We are consequently in favour of **binding mutual recognition**.

<u>50. Credit Risk Mitigation, Annex VIII, Part 1, point 28</u>

We believe that, if the desired harmonisation of supervisory practices is to be achieved, a competent authority's decision on the eligibility of a financial institution as a credit protection provider should be binding on all other national supervisors in the EU.

We are consequently in favour of **binding mutual recognition**.

51. Credit Risk Mitigation, Annex VIII, Part 2, point 9a (ii)

We believe that, if the desired harmonisation of supervisory practices is to be achieved, a competent authority's decision on the enforceability of a security interest should be binding on all other national supervisors in the EU.

We are consequently in favour of **binding mutual recognition**.

52. Credit Risk Mitigation, Annex VIII, Part 3, point 12

This national discretion allows for the use of internal models instead of supervisory or own-estimate volatility adjustments in the context of applying master netting agreements. We agree with CEBS that compliance with the conditions for making use of this rule should be verified as part of the approval process for internal models. In our view, however, all European banks which satisfy the relevant criteria should be allowed to apply the provision. We fail to understand why two banks which both meet the criteria for using internal models should receive different treatment from supervisors.

We urge CEBS to either recommend an **option for institutions** or make corresponding clarification in its advice on this discretion.

58. Securitisation, Annex IX, Part 4, point 30

In the interests of a level playing field, we support CEBS's proposed deletion of the discretionary component of this rule.

59. Securitisation, Annex IX, Part 4, point 53 (last sentence)

We welcome the proposal to change this discretion into an option for institutions and agree with CEBS's suggested wording.

61. Operational Risk, Article 104.3

In our opinion, all European banks should have the right to use the alternative standardised approach. Satisfaction of all the relevant conditions should be the sole criterion for deciding whether or not to approve the use of this approach. It is up to the competent authorities to verify whether these conditions are met. If they are, no further discretionary leeway is required. This is the only way to ensure consistent supervisory practices across Europe.

We suggest that CEBS recommend an **option for institutions** or make it clear in its advice that banks may apply this approach as long as all qualifying conditions are met.

62. Operational Risk, Article 105.4

In our opinion, all European banks should have the right to make use of this provision provided that they satisfy the relevant conditions. It is up to the competent authorities to verify whether they do so. We believe that all European banks should receive equal treatment and do not understand why parent and subsidiary companies which are permitted joint application of the AMA approach should not be allowed also to fulfil the minimum requirements on a joint basis.

The present wording of Article 105.4 does not, in our view, ensure that all European banks can use this provision if they comply with the necessary conditions.

63. Operational Risk, Annex X, Part 2, points 3 and 5

Please see our comments on no. 61.

64. Operational Risk, Article 20.2 (Directive 2006/49/EC)

We suggest **deleting** this provision to avoid competitive distortions.

65. Operational Risk, Article 20.3 (Directive 2006/49/EC)

We advocate **deleting** this provision to avoid competitive distortions.

81. Trading Book, Article 18.2 and 3 (Directive 2006/49/EC)

We welcome CEBS's recommendation to the change this national discretion into an option for institutions and agree with the suggested wording.

82. Trading Book, Article 19.2 (Directive 2006/49/EC)

We are strongly in favour of deleting the discretionary element of this rule. Nevertheless, we understand CEBS's concerns. The rule makes only general reference to a specific risk requirement; there is no pan-European definition of what such a requirement should be. This would possibly pose problems for some national supervisors. Our proposed solution would be for those competent authorities which have exercised this discretion in the past to provide guidance on suitable criteria. It is important for all supervisors in the EU to apply the same criteria if a level playing field is to be ensured. We therefore suggest that the criteria used by supervisors should be made public in the supervisory disclosure framework in order to promote converging practices in member states.

83. Trading Book, Article 19.3 and Annex I, point 52 (Directive 2006/49/EC)

We welcome the recommended joint assessment. To achieve the desired harmonisation of supervisory practices, however, the result of the joint assessment process should be binding on all competent authorities. We therefore advocate **binding mutual recognition**.

We also suggest publishing a central list of all third-country collective investment undertakings approved by European competent authorities.

84. Trading Book, Article 26 (Directive 2006/49/EC)

We fail to understand why all European banks should not be allowed to make use of this provision. A company in a group where risk is managed and monitored on a consolidated basis should, in our view, be allowed to offset trading book positions, for example, against those of another company in the group. This procedure is practical, makes sound economic sense and facilitates consolidated risk management.

We believe this national discretion should be changed into an **option for institutions**.

91. Trading Book, Annex I, point 14 (Directive 2006/49/EC)

The standardised measurement method is a simple, homogeneous approach to calculating a bank's capital requirements for market risk. To enable risk to be reflected with sufficient accuracy while at the same tome ensuring that implementation is as straightforward as possible, this approach is less risk-sensitive than internal risk models. We reject the proposal to introduce a higher specific risk charge to cover any underestimation of risk because it is not clear how banks are supposed to calculate these higher capital charges. In our view, it would be better to address any underestimation of risk under Pillar 2.

We therefore advocate **deleting** this rule from Directive 2006/49/EC entirely.

93. Trading Book, Annex I, point 35, first sentence (Directive 2006/49/EC)

We recommend changing the national discretion into an **option for institutions**. Competent authorities should set standard, objective criteria for applying a lower capital charge to cover the specific risk of highly liquid assets and monitor compliance on the basis of these criteria.

95. Trading Book, Annex III, point 2.1, last sentence (Directive 2006/49/EC)

We believe that all European banks should have the option of using net present value to calculate net open positions in currencies and in gold. We see no justification for failing to give banks equal treatment and therefore advocate changing the discretion into an **option for institutions**.

114. IRB, Annex VII, Part 4, point 48, last sentence

Where exposures to counterparties in other member states are concerned, it should be mandatory for competent authorities to recognise the number of days past due set by the competent authority in the counterparty's home country. This is the only way to avoid further competitive distortion.

We are consequently in favour of changing the recommendation to **binding mutual recognition**. This provision should be deleted by the end of 2014 at the latest.

116. IRB, Article 89, last sentence

To promote the harmonisation of supervisory practices, we suggest recommending **binding mutual recognition**.

125. Securitisation, Annex IX, Part 4, point 43

We believe all European banks should have the right to assign a derived rating to an unrated position in an ABCP programme provided that the relevant conditions are met. It is then up to the competent authorities to verify compliance with these conditions.

We therefore suggest that CEBS either change the recommendation into an **option for institutions** or clarify in its advice that banks may make use of the option if they comply with the associated conditions.

126. Securitisation, Annex IX, Part 4, point 43, last sentence

In our view, the waiver of the requirement for the ECAI's methodology to be publicly available should be applied by all national supervisors in a uniform manner.

127. Securitisation, Annex IX, Part 4, point 58

We would ask all competent authorities to implement this provision in a uniform manner.

129. Securitisation, Article 97.2

In our opinion, all competent authorities should implement this provision in a uniform manner.

145. Standardised Approach, Annex VI, Part 1, point 78

We advocate changing the recommendation into **binding mutual recognition**. It would not be logical for a third-country CIU to be recognised by the competent authority in one member state, but not by the competent authority in another. We strongly support the proposed joint assessment process.

148. Standardised Approach, Article 81.3

The result of the joint assessment of whether or not to recognise an ECAI should be binding on all national supervisors. We therefore suggest recommending **binding mutual recognition**.

149. Standardised Approach, Article 82.2

This provision enables the competent authorities in one member state to recognise the mapping of ratings and credit quality steps carried out by another member state without conducting their own mapping process. The results of this existing joint assessment process should be binding on all national supervisors. We therefore advocate recommending **binding mutual recognition**.

150. Transitional Provisions, Article 154.1, second paragraph

In the interests of a level playing field, we support CEBS's proposal to delete the rule on setting a higher number of past due days at the end of the transitional period.

We would naturally be happy to expand on any of these points on request.

Yours sincerely
on behalf of the Zentraler Kreditausschuss,
Bundesverband deutscher Banken

Dirk Jäger Anja Schulz

cc: Mr Patrick Pearson, DG Internal Market and Services, European Commission