22 May 2008

Consultation paper on CEBS's technical advice to the European Commission

on options and national discretions

Executive summary

1. This consultation paper sets out CEBS's preliminary views on the issues called for in the European Commission's (the 'Commission') Call for Advice on options and national discretions in the Capital Requirements Directive ('CRD').

2. As specified by the Commission, the scope of CEBS's work includes the 101 options and national discretions identified in CEBS's supervisory disclosure framework, as well as the mutual recognition clauses (separately identified in the supervisory disclosure framework) and the corresponding national discretions. A number of other potential discretions were identified by the industry in their responses to CEBS's public questionnaire of July 2007.

3. CEBS started its technical work with a thorough analysis of the responses to the questionnaire to determine the importance of each option and national discretion for its members and market participants. CEBS also conducted a high level Impact Assessment including a qualitative cost/benefit analysis of the national discretions to help in the formulation of the draft proposals presented in this report.

4. CEBS's Consultative Panel nominated industry experts to be part of a complementary working group on options and national discretions which met on a regular basis with CEBS. The working discussions between CEBS and the industry's experts were helpful given the scale and nature of the challenge and were successful in bringing more clarity to the issues surrounding national discretions.

5. As a result of its work CEBS is presenting for public consultation its preliminary proposals. CEBS is proposing to keep as a national discretion approximately one fifth of the 152 provisions covered in its analysis, albeit where possible with accompanying proposals to alleviate any negative side-effects of those national discretions. In any event, it should be noted that more than one third of those national discretions will expire within a relatively short period. For the other discretions, which form the large majority, CEBS is proposing solutions that it believes can bring about further harmonization of supervisory practices

and levelling of the playing field among institutions. Of these, CEBS is proposing for approximately one fourth to keep as, or to transform into, a supervisory decision to be implemented and applied on a case by case basis. CEBS believes its proposals strike the right balance between the prudential concerns of its members, the flexibility supervisors need to perform their duties and the interests of domestic and cross-border operating institutions.

6. The public consultation will run until 15 August 2008. CEBS welcomes market participants' views on the preliminary proposals put forward in the Annex. In addition, CEBS is seeking more detailed feedback on a number of specific provisions – 3, 31, 33, 38, 41, 43, 44, 45, 59, 61, 63, 81, 82, 86, 87, 89, 90, 93, 95, 96, 98, 100, 112, 113, 116, 117, 118 and 119 - as mentioned in the Annex. Respondents' feedback is particularly welcomed for discretions number 41, 43, 44 and 45.

Background

7. In May 2007 the Commission issued a Call for Technical Advice (No. 10) on options and national discretions in the CRD.[1]

8. CEBS was asked to conduct a technical analysis of the exercise of options and discretions identified in CEBS's supervisory disclosure framework by indicating for each of them: i) the manner of exercise; ii) whether CEBS deems it appropriate, with a view to achieving convergence of supervisory practices, to seek further harmonisation; iii) where consensus may not be found on the deletion of an option or discretion or on the use of mutual recognition, the precise reason for this, including the views expressed by the majority and the minority of its Members; and iv) where appropriate, drafting proposals.

9. In performing this work, the Call for Advice suggests that CEBS classifies the options and national discretions into the following categories: i) options and discretions that might be subject to mutual recognition along the lines set out in the Annex to the Call for Advice; ii) possible legitimate options and discretions; and iii) options and discretions which should be deleted.

10. The Call for Advice indicates that on-going consultation with the industry should play a key role in providing insight into the ways forward for dealing with the reduction in the number of national discretions. CEBS has also endorsed, and stressed the importance of, the dialogue with the industry.

11. CEBS was requested to deliver its technical advice by end-May 2008. As acknowledged by CEBS and the Commission, the work on the reduction of options and national discretions is a particularly challenging task and the timeline had to be expanded to reflect this. The extension of the timeline was also agreed by the industry experts nominated by the Consultative Panel to work with CEBS on this issue.

12. The group of industry experts nominated to work with CEBS on the Call for Advice from the Commission urged CEBS to invite the Commission to consider some of the findings in the present draft advice during the current review of the CRD. The group indicated that these draft proposals on which agreement exists between CEBS and the industry experts were in a form which could be considered by the Commission, should it so wish, in its current review.

13. The draft advice contained in this consultation paper sets out **CEBS's preliminary views on the issues included in the Commission's Call for Advice on options and national discretions in the CRD. It is published for public consultation. It will also be delivered to the Commission as initial input to the Call for Advice.** The final advice is expected to be delivered by October 2008.

14. **CEBS welcomes market participants' views on the preliminary proposals put forward in the Annex. In addition, CEBS is seeking more detailed feedback on a number of specific provisions – 3, 31, 33, 38, 41, 43, 44, 45, 59, 61, 63, 81, 82, 86, 87, 89, 90, 93, 95, 96, 98, 100,**

[1] http://www.c-ebs.org/documents/CFA10onnationaldiscretions16052007.pdf

112, 113, 116, 117, 118 and 119 - as mentioned in the Annex. Respondents' feedback is particularly welcomed for discretions number 41, 43, 44 and 45.

15. **The public consultation will run until 15 August 2008.** Comments should be sent to the following email address: cp18@c-ebs.org. Comments received will be published on CEBS's website unless respondents request otherwise. **A public hearing will be organized on 17 June 2008 at CEBS's premises in London to allow interested parties to share their views with CEBS** [details of which are available on CEBS website: http://www.c-ebs.org/keydates.htm].

Methodology

On-going consultation with market participants and supervisors

16. In the summer of 2007 CEBS developed a questionnaire on the CRD options and national discretions and on possible solutions for their reduction. Members, observers and market participants worked together on the drafting of the questionnaire.

17. In July 2007 the questionnaire inviting market participants to provide input to CEBS was posted on the website for a three-month response period that ended on 19 October 2007[2]. In parallel, a questionnaire was sent to CEBS's members and observers.

18. Answers were received from all the supervisors represented in CEBS and from 16 market participants (13 from trade associations and 3 from individual institutions).[3] Some of the industry responses focused only on those areas of the national discretions which had been identified as having a special interest for them.

19. At the end of 2007 a CEBS working group was set up and members and observers of the Consultative Panel were invited to nominate industry experts to be part of a complementary working group on options and national discretions. CEBS's working group met on a monthly basis and also twice with representatives from the industry (in addition to teleconferences).

20. The working discussions between the CEBS working group and the industry experts were open, transparent, non-binding and successful in bringing more clarity to the issues surrounding national discretions.

Scope of the work

21. As specified by the Commission, the scope of CEBS's work includes the 101 options and national discretions identified in CEBS's supervisory disclosure

[2] http://www.c-ebs.org/press/.htm

Industry's responses are published on CEBS public website under: http://www.c-ebs.org/Advice/optionsND_response.htm framework, as well as the mutual recognition clauses (separately identified in the supervisory disclosure framework) and the corresponding national discretions. A number of other potential discretions were identified by the industry in their responses to CEBS's questionnaire.

22. CEBS understands that '**Options and National discretions**'[4] can be interpreted broadly or narrowly. The narrow definition limits options and national discretions to those provisions in the CRD which allow for a Member State or its competent authorities i) to choose how all relevant institutions in the jurisdiction should comply with a given provision, selecting from a range of alternatives set out in the Directive; and ii) to choose whether or not to apply a given provision to all institutions in the jurisdiction. In these cases, the level-playing field between institutions can be impacted, and for - institutions and banking groups operating cross-border this can lead to additional burdens to accommodate the different approaches in each of the Member States which they operate in. Where the proposals set out in the Annex refer to national discretions, this limited definition is referred to.

23. However, for the purpose of determining the scope of the work CEBS has also taken on board the suggestions put forward by market participants in their responses to CEBS's questionnaire. This means that in practice a broader pragmatic approach was taken to the meaning of 'options and national discretions'. In addition to each of the provisions identified in the Supervisory Disclosure framework, and the provisions with a mutual recognition clause attached a number of other provisions were put forward by industry respondents as part of the new texts in the CRD and were capable of being applied, in the perception of the industry participants, as an option or national discretion in some or all of the Member States. These provisions were included as part of the work regardless of the opinion of CEBS's members and of the outcome of the subsequent analysis. This allowed for a full review of all provisions where the issue of national discretion might play a role, even if only to clarify that it does not or should not.

High level considerations

24. A number of high level considerations were developed by CEBS to help frame and guide the discussion on possible solutions for individual options and national discretions:

    a) The existing degree of convergence in the exercise of the options and national discretions by Members States is an important parameter, but not in itself a determining factor for deciding the way forward in relation to a national discretion; there may be justifiable grounds for applying a national discretion in a different manner.

    b) The decision on options and national discretions should take into account as much as possible both cross-border and domestic aspects, i.e. the

[4] The current work on options and national discretions will have implications in what needs to be disclosed by members under the CEBS's supervisory disclosure framework. This issue will need to be addressed subsequently.

interests of domestically focussed institutions should not be down played when the interests of cross border institutions are considered and vice-versa.

c) The treatment (keeping, deleting the provision, deleting the discretion or transforming it into an option for credit institutions) of options and national discretions should be subject to a high level impact assessment, including a qualitative cost/benefit analysis. Consideration should also be given to e.g. legal continuity for important businesses or a transitional period or a grandfathering clause if this would allow a gradual adjustment of the business.

d) In general, the discretionary part of options and national discretions could be deleted if the fulfilment of a set of criteria to be applied by the credit institutions/investment firms is satisfactorily defined in the CRD. The more lenient approach allowed would subsequently be open to the institutions subject to them remaining within the boundaries set by the criteria.

e) Where appropriate the national discretion can be replaced with a joint/common assessment process to be carried out by all supervisors that wish to participate, similar to the current practice in the recognition of ECAIs.

f) Solutions using the option that is most risk sensitive and proportionate are preferred.

g) The possibility of removing options and national discretions rooted in local market conditions should also be examined, e.g. by looking at the possibility of achieving the same purpose by applying an existing proportionality provision. Binding mutual recognition should be taken into consideration as a possible solution for achieving a level playing field across institutions active in a Member State or between Member States.

h) In areas where competent authorities and the industry have insufficient experience options and national discretions should be kept for the time being, subject to a review clause. Where it is not expected they will acquire the experience due to the lack of relevance in practice, the provision should be deleted from the CRD.

Impact assessment

25. CEBS has been asked to develop its Advice to the Commission in a manner consistent with the 'better regulation agenda'. This has been achieved by following, as far as time constraints allowed, the impact assessment guidelines that have been developed by the 3L3 committees[5].

26. Impact Assessment (IA) advice was sought from CEBS members outside the expert group. Furthermore various panels of stakeholder groups that assist

[5] 'Impact Assessment Guidelines for EU Lamfalussy Level 3 Committees' April 2008, http://www.c-ebs.org/documents/3L3.IA.GL.pdf

CEBS, from both competent authorities and the above mentioned industry experts, were invited to comment on CEBS's proposals during the assessment process.

27. The IA is designed to help policy makers describe and explain the decision making process and to identify policies that should be implemented. It is prepared as a basis for discussion and is not intended to prejudge the final form of any decision to be taken. The main findings from the IA are presented in the summary of findings below.

Glossary

28. For the purpose of the present report the findings on how to deal with the various options and discretions have the following meanings:

   a) 'Keep as national discretion' – refers to a discretion (given to Member States or competent authorities) that should be kept in its current form for one of the following reasons:

      i) The provision can only be changed as part of a future general overhaul of the subject matter (such as the scope of application and definition of capital);

      ii) The provision of which the national discretion is part will expire (as a transitional or grandfathering provision) before or by the end of 2011, which means that any change in the text of the CRD would have no or very limited validity by the time the provision will have been amended by the legislative process.

      iii) The provision is a genuine reflection of local market specificities and national laws other than the banking supervision laws.

      iv) Further work on the provision is hampered by the lack of practical experience and/or the lack of satisfactory common criteria at this point in time, or there are no other viable alternatives to keeping it.

   b) 'Mutual recognition' – refers to a situation in which Member States are allowed or in some cases obliged to recognize the decision taken by another Member State if their institution wants to use it in its business.

      i) Where **binding mutual recognition** is explicitly mentioned, the solution offered would require each Member State and its competent authorities to allow their institutions to use the judgement or opinion of another Member State or competent authority on (a) issues which exclusively relate to features of the local market and (b) issues which relate to local laws outside the scope of banking supervision, such as company law, bankruptcy law, contract law and securities law.

      ii) **Non-binding mutual recognition** is offered as a default option where there may be relevant information not available to the other competent authorities, or where the judgement on a market or individual entity relates to markets in various jurisdictions inside or outside of the EU. In this case each Member State and its competent authorities could allow their institutions to use the judgement or opinion of another Member State or competent authority.

c) **'Keep as or transform into a supervisory decision'**[6] **–** refers to a provision that should be implemented by all Member States and be applied on a case by case basis by their competent authorities and not (either by the Member State or the authority) to all institutions in the relevant jurisdiction. In particular, when the Directives refer to the need for an institution to obtain a competent authority's approval or authorisation for various purposes, such authorisation or approval may be discretionary, but if the decision is made on an individual basis relating to the specific circumstances of the entity involved, it does not constitute a national discretion. There are various subtypes of supervisory decisions:

   i) where there is judgement by the supervisor, but no choice (if in its judgement the criteria are fulfilled, the supervisor has to agree with the choice of the credit institution or investment firm);

   ii) where there is judgement and choice by the supervisor (if it thinks the criteria set are fulfilled, but there is also a subjective choice by the supervisor as to whether the application is a good idea in this specific case).

   Both of the subtypes can take place in the context of a supervisory approval process (e.g. IRB) that competent authorities conduct on a case by case basis.

d) **'Transform into a general rule' –** refers to the potential solution offered in CEBS's questionnaire to the industry and CEBS's members. As part of the analysis, this potential solution often overlaps either with the 'option for credit institutions' or with the 'deletion of the discretionary part of the provision', both as described below. As a result, in this draft Advice, 'transform into a general rule' is no longer used as a proposed solution, except in the context of the analysis of the responses to the questionnaire.

e) '**Delete or remove an option or a national discretion**' – refers to a situation in which: i) only one of the options is maintained and it is therefore transformed into a mandatory option to be applied by all credit institutions or by all Member States; ii) the exercise of a given discretion becomes mandatory on all Member States or competent authorities; or iii) the provision will be completely deleted from the CRD. The deletion can happen immediately or with a transitional provision.

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[6] CEBS acknowledges that there a number of issues to take into consideration regarding its proposal for the implementation of the "supervisory decisions" by all Member Sates:

i) The effective distribution of powers in the Member States is distinct: in some jurisdictions the competent authority needs a specific legal provision to have the power to exercise a discretion; in other jurisdictions the competent authorities have been granted wider regulatory powers and there is no need formally to implement the discretion in the law;

ii) Given the national legal environment (outside of banking supervision laws) the conditions set in some of the discretions can never be satisfactorily fulfilled, in which case the Member States would not need to implement a specific "supervisory decision".

f) **'Option for credit institutions or investment firms' –** refers to the following types of situations in which:

i) the credit institution or investment firm can choose between the two different options set out in the Directive;

ii) the credit institution or the investment firm is explicitly given the choice whether or not to apply the provision;

iii) the credit institution or the investment firm is implicitly given the choice to make use of e.g. a mutual recognition clause (i.e. allowing it, but not forcing it, to use a more lenient risk weighting due to local market circumstances).

g) **'Joint assessment process' –** refers to the sharing of information and expertise, as well as jointly investigating and/or interviewing relevant parties, aiming at reaching a common understanding of the facts as well as, where possible, reaching a consensus on the outcome of the analysis. The consensus view is non-binding but forms a strong basis upon which, coherently with their national legal framework, competent authorities/Member States will take their decision in each jurisdiction. Depending on the subject matter there are two categories of joint assessment processes:

i) a joint assessment process based on the application of an individual third party (e.g. ECAI), where all supervisors to whom a similar application has been made are invited to participate on a voluntary basis in the process (the limitation is due to, amongst other factors, privacy reasons, see the ECAI process as agreed and published by CEBS on GL07).

ii) a joint/common assessment process regarding a legal system or general occurrence (e.g. equivalence of third country supervisory and regulatory arrangements), where all supervisors in the EU shall be invited and all interested supervisors can share information and participate in the work on a voluntary basis. The outcome of the common/joint process forms a strong basis on which competent authorities will take the decision in their jurisdiction.

h) **'Grandfathering'** - refers to provisions that allow an old rule to continue to apply to certain existing situations, where a new rule will apply to all future situations[7].

i) **'Transitional provision'** - refers to provisions in an instrument of law designed to ensure a smooth transition from the old legal regime to the new legal regime[8].

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[7] Applied to capital instruments that means that instruments issued under a prior legal regime may continue to be used, but may not be issued any more.

[8] Article 152ff of the CRD provide examples of the different forms that such provisions can take, e.g. by providing capital floors calculated with reference to Directive 2002/12 for a limited period of time or by granting limited derogations from CRD requirements.

Summary of findings

Summary of CEBS's preliminary proposals

29. CEBS started its technical work with a thorough analysis of the responses to its questionnaire to determine the importance of each option and national discretion for its members and market participants. CEBS also focused its efforts on gaining more insight into the reasoning behind each of the discretions better to assess the best way forward.

30. Keeping in mind the objectives of this exercise – reduction of options and national discretions in the CRD in order further to harmonize supervisory practices, CEBS used the high level considerations it had developed and qualitative cost/benefit analysis to formulate its proposals.

31. As a result CEBS is proposing to keep as a national discretion approximately one fifth of the 152 provisions covered in its analysis, where possible with accompanying proposals to alleviate any negative side effects of those national discretions. In any event, it should be noted that more than one third of those national discretions will expire within a relatively short period. For the other discretions, which form the large majority (four fifths) CEBS is proposing solutions that it believes can ensure further harmonization of supervisory practices and the enhancement of the level playing field among institutions. Of these, CEBS is proposing for approximately one fourth to keep as, or to transform into, a supervisory decision to be implemented and applied on a case by case basis. In CEBS's view this solution should reduce the costs associated to the existence of national discretions for groups with cross-border activities, for example in the context of the approval of internal models.

32. CEBS believes its proposals strike the right balance between the prudential concerns of its members, the flexibility supervisors need to perform their duties and the interests of domestic and cross-border institutions. See the table below for an overview of the discretions which should be kept, and for what reason, as well as for an overview of the various solutions offered.

33. If as a result of CEBS's Advice the CRD is amended, CEBS will update its supervisory disclosure framework accordingly. Meanwhile, CEBS is continuing its efforts to upgrade and clarify the information available in the framework across jurisdictions through a continuous dialogue with its members.

34. Please see the **Annex** for a comprehensive overview of the analysis and proposals for each option and national discretion. To give a general idea of the direction the work of CEBS has taken, an overview of the proposals made is contained in the following table.

Draft proposals		**Number of the specific national discretion**[9]	**Total**
1) options and discretions which should be kept in the current form	i) because the provision can only be changed as part of a future general overhaul of the subject-matter	4, 5, 6, 9, 10	5
	ii) the provision will be deleted in a short period through the expiry of their validity	69, 70, 71, 72, 73, 74, 75, 78, 79, 80, 151, 152	12
	iii) because the provision is rooted in features of a local market and national laws other than the banking supervision laws	49, 50, 51, 136, 138, 140, 142	7
	iv) due to the lack of practical experience and/or the lack of satisfactory common criteria, or the lack of other viable alternatives to keeping it	15, 19, 32, 34, 42, 55, 67, 81, 82, 112, 113,	11
2) options and discretions which should be subject to mutual recognition	i) binding mutual recognition	25, 31, 39, 68, 102, 103, 104, 105, 110, 111,	10
	ii) non-binding mutual recognition	23, 24, 27, 49, 50, 51, 83, 114, 116, 132, 145, 148, 149, 150	14
3) options and discretions which should be kept as or transformed into a supervisory decision to be used on a case by case basis		2, 3, 8, 11, 12, 13, 14, 16, 17, 20, 21, 22, 23, 24, 26, 27, 37, 38, 46, 52, 61, 62, 63, 64, 77, 83, 84, 93, 95, 96, 115, 125, 126, 127, 129, 139, 144	37

[9] "Number" refers to the order given to each national discretion in turn in the Annex simply for the purposes of a consistent, short-hand way of referring to a particular discretion.

4) options and discretions which should be deleted or removed	the redrafted provision becomes a rule	18, 28, 29, 36, 40, 48, 53, 58, 66, 82, 91, 94, 97, 124	14
	the provision is completely deleted from CRD	30, 31, 33, 35, 41, 43, 44, 45, 57, 85, 86, 87. 88, 89, 90, 96, 98, 99, 100, 109, 141	21
5) options and discretions which should be kept or transformed into an option for credit institutions or investment firms		1, 7, 14, 47, 54, 56, 59, 60, 65, 76, 81, 92, 93, 95, 101, 106, 107, 108, 128, 137, 141, 143	22
6) options and discretions in which an EU Joint assessment process should be considered		23, 24, 27, 83, 130, 131, 145, 148, 149	9
Out of scope		117, 118, 119, 120, 121, 122, 123, 133, 134, 135, 146, 147	12
Options and discretions where more detailed feedback from respondents is invited		3, 31, 33, 38, [41, 45], [43, 44], 59, [61, 63], 81, 82, [86, 87, 89, 90, 98, 100], 93, 95, 96, 112, 113, [116, 117, 118, 119]	27

Note: some national discretions are classified in two different categories because: i) they include two provisions and different treatments are proposed (e.g. 14, 81, 141); or ii) it is proposed to add a reference to an EU joint assessment process (e.g. 23, 24, 27, 83, 145, 148, 149); or iii) it is proposed to add a mutual recognition clause (e.g. 23, 24, 27, 50, 51, 83); or iv) two alternative solutions are proposed at this stage (e.g. 31, 82, 93, 95, 96).

35. For most of the options and national discretions CEBS is proposing to keep there is still a lack of practical experience and more time is needed to allow institutions and supervisors to gain the necessary experience in order to assess the need for keeping the national discretion (e.g. IRB). CEBS is also proposing to keep other national discretions because they relate to a subject under review in other *fora* and can only be dealt with in that wider context (e.g. definition of capital) or because they will expire within a relatively short time. CEBS also believes that a number of the remaining national discretions, which are to be kept, could potentially be removed from the CRD if good quality criteria are developed and reliance is placed on the supervisor to assess whether the criteria are fulfilled.

Summary of findings from the Impact Assessment

36. CEBS adopted a 'fit for purpose' approach to the IA. Given time constraints and the scale of the exercise, this meant focusing on a qualitative analysis of the case for/against keeping the 152 national discretions under review. The industry working group expressed its support for performing a qualitative IA.

37. CEBS first considered the nature of the problem that each discretion had been introduced to solve. In particular, it was necessary to establish whether or not the discretions were addressing relevant market failures. This required answers to the following questions:

- What problem was the discretion seeking to address?
- Was there any evidence to suggest that the problem was material? and
- What was the likelihood of there being a market-based solution to the problem in the short-to-medium term?

38. Of the 152 discretions that were assessed, few were found not to be addressing relevant market failures. Such discretions could not reasonably be retained on economic grounds because keeping them would provide no benefits and impose only costs. As a result, these discretions can be deleted without the need for further analysis.

39. Of the vast majority of discretions where the analysis suggested that they were addressing a relevant market failure, a high level CBA was used to evaluate the case for (1) keeping the discretion or (2) removing the discretion (and considering whether to replace it with a different rule), depending on whether or not the CBA suggested that net benefits could be expected to arise.

40. In considering the impacts of these discretions it was necessary to take into account:

- the direct costs/benefits to supervisors, compliance costs/benefits to regulated entities, and, just as importantly, the indirect costs/benefits to the market;
- whether the costs and benefits identified were likely to be evenly distributed across MS or concentrated in a single/handful of MS or distributed differently by firm type or firm size; and
- whether the costs and benefits of each discretion were independent of each other or whether there were any important interdependencies to be considered.

41. In summary, of the discretions determined to be addressing a relevant market failure, our high level CBA indicated that for around 10 % of the discretions assessed there was a reasonable expectation of net costs from removing the discretions and therefore a reasonably clear case for them to be retained. The main drivers behind this were strong expectations or evidence that firms would manage their activities with a higher sensitivity to

risk, which reduces the probability of default and leads to fewer bank failures. In a small number of cases discretions were expected to be associated with significant costs but are still recommended for retention because they are expected to generate substantial benefits.

42. In the case of roughly 15 % of all assessed discretions the high level CBA suggested a reasonable expectation of net benefits from changing the discretion, therefore indicating a case for removing it entirely from the CRD or transforming it into a general provision or an option for the industry. In these cases material costs could be identified but larger benefits were anticipated by giving incentives for market development and integration. This promotion of convergence is likely to lead to increased competition. The potential for industry to incur costs in making systems changes was also a consideration in some proposals that provide for an option for credit institutions or investment firms as opposed to otherwise requiring a particular treatment that might appear more favourable in terms of say the amount of regulatory capital.

43. In cases where the CBA was ambiguous or uncertain further challenge was undertaken with the emphasis being on the need to justify retention. Uncertain CBA outcomes were due to the lack of evidence on the materiality of the discretions' effects, disagreement or major impact differences among MS. On these, CEBS is looking for further input as part of the consultation process.

44. In general the provisions were far from being homogeneous, but some options and national discretions could be grouped together for IA/CBA purposes. The main groups identified for common assessment were:

    a) provisions related to the ECAI recognition process; and

    b) provisions relating to the treatment of exposures secured by real estate and that are based on local market conditions.

Annex: Comprehensive overview of the analysis and proposals on each option and national discretion

This Annex, presenting CEBS's analysis and preliminary proposals for each provision included in the scope of the work, is organized in the following manner:

1. **Overview of exercise:** Based on the data currently published on CEBS's website under the supervisory disclosure framework, CEBS presents statistical information on the exercise of the national discretions by its members.

2. **Overview of responses:** CEBS presents an overview of the responses from members and market participants to its questionnaire. Respondents were asked to express their preference regarding the future treatment of options and national discretions by classifying them in the following way: to keep (in the present form; for the supervisors to decide on case by case basis; subject to mutual recognition; as an option for credit institutions); to remove (completely from the CRD immediately or after a transition period; or to transform into a general rule removing the other option)[10].

3. **Main drivers**: CEBS outlines the main reasons indicated by respondents regarding their preference for the future treatment of options and national discretions.

4. **Impact on business:** CEBS points out if respondents to the questionnaire expect an impact on their business from the divergent exercise of the national discretion.

5. **Possible solution:** CEBS discusses the best way to deal with the national discretion and presents a possible solution and its reasoning for consultation with market participants. In some cases more detailed feedback is invited from respondents to the public consultation.

6. **Drafting proposal**: If necessary a drafting proposal is included to implement the solution CEBS is consulting on.

7. **Other remarks**: If necessary CEBS highlights e.g. the implications of its proposal for the supervisory disclosure framework or some extra reasoning for its proposal.

[10] It should be noted that during its discussions CEBS identified that respondents may have supplied answers to the questionnaire based on an original understanding or 'definition' that was subsequently clarified (for example, see 'glossary'). Therefore any figures for numbers of respondents and/or members favouring a particular option should be viewed as indicative only and not necessarily representative of any definitive positions.

Table of contents

Area: Own Funds

1. Own Funds, Article 57 (Directive 2006/48/EC)

"Subject to the limits imposed in Article 66, the unconsolidated own funds of credit institutions shall consist of the following items: […]

(b) reserves within the meaning of Article 23 of Directive 86/635/EEC and profits and losses brought forward as a result of the application of the final profit or loss; […]

For the purposes of point (b), the Member States may permit inclusion of interim profits before a formal decision has been taken only if these profits have been verified by persons responsible for the auditing of the accounts and if it is proved to the satisfaction of the competent authorities that the amount thereof has been evaluated in accordance with the principles set out in Directive 86/635/EEC and is net of any foreseeable charge or dividend."

Objective of the discretion: This national discretion allows Member States to specify the composition of own funds. By including verified interim profits credit institutions have the possibility of increasing the amount of own funds.

1. **Overview of exercise:** 80% of Member States have exercised this national discretion, 7% of Member States with conditions ("only not distributed profit at the end of the year"; "on a consolidated basis") and 13% Member States have not exercised it.

2. **Overview of responses:** 1 Member, that did not exercise the national discretion, argues that the "discretion is one of the tools used against the current fast credit growth in the country, deletion of this option will have a potential anti-discipline effect over the banking system" and judges it as very important. The majority of respondents (8 respondents from the industry and 14 from the membership) want to remove the discretion and transform it into a general rule; 17 respondents want to keep it (10 in its present form, 3 as a supervisory discretion, 1 to apply mutual recognition and 3 as an option for credit institutions). 2 Members have no preference. Most respondents state that a common treatment/definition of own funds is judged essential. The discretion is generally judged as being very important (13 consider it as very important, 10 as important, 6 as fairly important and only 2 respondents are indifferent). Transformation into a general rule and mutual recognition are mentioned as possible solutions; also, a wording suggestion ("interim profits reviewed by external auditors") is given. The industry suggests transformation into a general rule.

3. **Main drivers**: Members that want to keep the national discretion mention the current revision of the own funds regime, existing market practice, business reasons and the potential impact of deletion. Respondents who want to transform the national discretion into a general rule mention that interim profits are available to cover losses, a common treatment across the Member States, the high degree of existing convergence (potential impact of deletion) and business reasons (the inclusion of interim profits instead of other items is more favourable). The industry strongly favours a general rule and mentions

the Transparency Directive requiring the disclosure of the profit and loss account for the first six months of the current financial year (Dir. 2007/14/EC, Article 3, §2) and the high degree of existing convergence. Some suggest that it would be "*useful to specify that interim profits include intra-annual profits, as some* Member States *interpret this provision more narrowly than others*".

4. **Impact on business:** 14 respondents do not expect any impact resulting from divergent exercise of the discretion, only 6 respondents expect an impact on their business (of which one states 'significant impact').

5. **Possible solution:** As the discretion in Art. 57 Dir. 2006/48/EC is exercised by the majority of Member States and as the Article also states explicit and clear conditions to be fulfilled for making use of it, there is no necessity to keep it as a national discretion. The assessment of whether the criteria are fulfilled can be done by any of the parties involved. In that case, the standard supervisory process is to give the responsibility to the credit institution, subject to the normal challenge process of the supervisor (as referred to in the Article). As a result, transforming the national discretion into **an option for credit institutions** is proposed. This will allow a credit institution to have any intra-annual profits which have been verified in accordance with the criteria taken into account, and will create a level playing field in the EU with clear criteria. As the text of the provision already clearly indicates that such interim - be they the result of a monthly, quarterly, or semi-annual interim statement - profits, can be taken into account if the conditions are fulfilled, no further clarification of the text is deemed necessary.

6. **Drafting proposal:**

For the purposes of point (b), credit institutions may include interim profits before a formal decision has been taken if these profits have been verified by persons responsible for the auditing of the accounts and if it is proved to the satisfaction of the competent authorities that the amount thereof has been evaluated in accordance with the principles set out in Directive 86/635/EEC and is net of any foreseeable charge or dividend.

2. Own Funds, Article 58 (Directive 2006/48/EC)

"Where shares in another credit institution, financial institution, insurance or reinsurance undertaking or insurance holding company are held temporarily for the purposes of a financial assistance operation designed to reorganise and save that entity, the competent authority may waive the provisions on deduction referred to in points (l) to (p) of Article 57".

Objective of the discretion: This discretion allows competent authorities not to deduct certain temporarily held shares from own funds (resulting in a higher amount of own funds). This is based on prudential considerations.

1. **Overview of exercise:** 70% of Member States have exercised this discretion, 3% of Member State with conditions ("subject to prior written Financial

Regulatory approval”). 23% of Member States state that they do not exercise it.

2. **Overview of responses:** Overall, the majority of respondents (21) are in favour of keeping the discretion; 15 respondents would prefer to remove it. However, it is mainly Members that want to keep it (9 in the present form, 9 for supervisors to decide). 6 of industry’s respondents favour a general rule. The national discretion is judged fairly important by 13 respondents, 5 respondents find it very important, 7 fairly important and 6 are indifferent. For 1 respondent it is not relevant at all.

3. **Main drivers**: Members that want to keep the national discretion mention the current revision of the own funds regime, the possibility of easing crisis management and the potential impact of deletion. Respondents who want to change the national discretion into a supervisory decision (case by case) mention the importance of giving an incentive to participate in assistance operations, the varying degrees of riskiness of such investments (they mention that financial assistance might be quite risky and not temporary), the limited use of it (necessary for the stability of the banking system) and the different nature of the investments that make a case by case decision necessary. Respondents who want to transform the national discretion into a general rule mention common treatment across the EU and business reasons (stimulation of active involvement in financial assistance). One respondent suggests the non-inclusion of the items should be the general rule. The industry respondent who wants to keep the national discretion mentions the current revision of the own funds regime. Respondents who want to transform the national discretion into a general rule mention that the provision is a helpful means of containing a crisis, the high degree of existing convergence and the need for a uniform definition of own funds.

4. **Impact on business:** 13 respondents do not expect any impact resulting from divergent exercise of the discretion, 6 expect an impact on their business (of which 3 expect only a minor impact).

5. **Possible solution:** This provision is seen as helpful in times of crises and it definitely has to be decided on a case by case basis, as indicated by many of the answers received and by the provision itself. In fact it is our opinion that this provision **is not intended to be a national discretion, but a supervisory decision** to be applied on a case by case basis that should have been implemented and applied as such by all Member States (the provision says “the competent authority may waive” and not the Member States). The text from the Directive should be kept unchanged and the Member States that have not yet implemented this provision as a supervisory decision to be used on a case by case basis should be urged to do so as soon as possible.

6. **Drafting proposal:** No change necessary at the CRD level, but the provision should be implemented as a supervisory decision at the national level.

3. Own Funds, Article 59 (Directive 2006/48/EC)

"As an alternative to the deduction of the items referred to in points (o) and (p) of Article 57, Member States may allow their credit institutions 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 the level of integrated management and internal control regarding the entities which would be included in the scope of consolidation. The method chosen shall be applied in a consistent manner over time".

Objective of the discretion: This national discretion allows Member States to permit the use of alternative methodologies (Annex I Conglomerates Directive) for the calculation of capital adequacy instead of the deduction from own funds of certain participations (re/insurance undertakings, insurance holding companies) and capital instruments.

1. **Overview of exercise:** 57% of Member States have exercised this national discretion and 43% Member States have not exercised it.

2. **Overview of responses:** 24 responses are in favour of keeping the national discretion (8 would prefer to keep it in its present form and 11 to turn it into a discretion for credit institutions); 10 respondents would prefer to remove it (6 respondents suggest "delete", and 3 "general rule"). 4 responses indicate no preference. 5 respondents find the national discretion very important, 10 important and 6 fairly important. 5 are indifferent and 5 don't see any national relevance.

3. **Main drivers**: Members that want to keep the national discretion as it is mention the current revision of the own funds regime, level playing field considerations (between parent banks of financial conglomerates and those of non-FC), business reasons and cross-border aspects (avoidance of double deduction), potential impact of deletion, market specificities and insufficient experience in supplementary supervision. Respondents who want to change the national discretion into a supervisory decision (case by case) mention that applying the FCD methods may be justified in individual cases (based on conditions of the group). Respondents who want to change the national discretion into a discretion for credit institutions mention that they have a significant number of financial conglomerates in the domestic market with diverse profiles, the promotion of consistency with the conglomerates regime (avoidance of competitive distortions) and the necessity of giving credit institutions a choice. Respondents who want to remove the national discretion completely mention uniform treatment, market specificities and non-transposition in the local market. Some Members mention that they would appreciate clear rules and limits for the calculation of the own funds of banking groups and financial conglomerates and especially how to allocate own funds of the whole group to the different sub-groups (in the financial and insurance sectors) and institutions. ("The CRD and FCD should give clear guidance how the supervisor should assess the adequacy of capital of different groups and institutions".) Industry respondents favour turning the national discretion into a discretion for credit institutions to avoid competitive distortions between banks that are part of a financial conglomerate and those that are not.

4. **Impact on business:** 13 respondents do not expect any impact resulting from divergent exercise of the discretion, only 4 respondents expect an impact on their business.

5. **Possible solution:** The general tone of the answers received is that the possibility for credit institutions to calculate capital adequacy based on financial conglomerates' requirements is seen as enhancing the level playing field and that the application (choice of method) is seen as group specific and as cost efficient. It is to be noted that the Interim Working Committee on Financial Conglomerates (IWCFC) and the European Financial Conglomerates Committee are currently assessing the methods of consolidation. An eventual proposal to change this provision should take into consideration the results of their work. The advice of the IWCFC was given on 7 April 2008 including the proposal to delete the third method. If this is adopted in the FCD, the corresponding national discretion to method 3 in Article 59 Dir. 2006/48/EC should be deleted at the same time.

   According to the Financial Conglomerates Directive (2002/87/EC): "Member States shall allow their competent authorities, where they assume the role of coordinator with regard to a particular financial conglomerate, to decide, after consultation with the other relevant competent authorities and the conglomerate itself, which method shall be applied by that financial conglomerate." This provision entails a national discretion (which is outside the scope of this work) with modifications. Therefore the current proposal is to **transform into a supervisory decision** the permission to use method 1, 2 or 3, but to incorporate in the CRD similar modifications as the FCD contains. Additionally, as the use of method 1 (accounting consolidation) is dependent on the competent authority being "confident about the level of integrated management and internal control […]", this part of the provision is a **supervisory decision which is part of the approval process** to be applied on a case by case basis (i.e. explicit supervisory approval only for method 1). If the FCD national discretion is changed, the proposal is to adopt such changes also in this CRD national discretion. It is noted, however, that one Member considers that the current provision can, and should, be applied to any bank with an insurance undertaking (affiliate or subsidiary) regardless of whether it is part of a financial conglomerate or a group or not. And, furthermore, considers this discretion as outside the scope of the current work and so should remain as is. The drafting proposal may otherwise narrow the scope of application of the current discretion and so **respondents' views on this would be welcomed.**

6. **Drafting proposal:**

As an alternative to the deduction of the items referred to in points (o) and (p) of Article 57, *Member States* <u>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 group itself,</u> *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 […].*

4. Own Funds, Article 60 (Directive 2006/48/EC)

"Member States may provide that for the calculation of own funds on a stand-alone basis, credit institutions subject to supervision on a consolidated basis in accordance with Chapter 4, Section 1, or to supplementary supervision in accordance with Directive 2002/87/EC, need not deduct the items referred to in points (l) to (p) of Article 57 which are held in credit institutions, financial institutions, insurance or reinsurance undertakings or insurance holding companies, which are included in the scope of consolidated or supplementary supervision".

Objective of the discretion: This national discretion allows Member States to decide not to deduct certain holdings and participations in institutions included in the scope of their consolidation from solo-level own funds (resulting in a higher amount of own funds on an unconsolidated basis). This national discretion is based on prudential considerations.

1. **Overview of exercise:** 57% of Member States have exercised this national discretion, 7% of Member States with conditions ("partially applied - only in consolidated supervision", "partly applied"), and 37% of Member States have not exercised it.

2. **Overview of responses:** 20 responses were in favour of keeping this national discretion (14 in the present form, 2 as a supervisory decision, 1 to apply mutual recognition, 3 to turn into discretion for credit institutions); 16 respondents would like to remove it (3 indicate to remove it completely, 13 to transform it into a general rule); and 4 responses indicated no preference. The national discretion is judged rather important (10 classify it as very important, 12 as important, and 5 as fairly important; only 3 respondents are indifferent and for 2 it is not relevant).

3. **Main drivers**: Members that want to keep the national discretion mention the current revision of the own funds regime, the necessity to set solo prudential requirements, market specificities, business reasons, existing market practice, the strengthening of supervisory activities and the importance for financial groups. Respondents who want to change the national discretion into a supervisory decision (case by case) mention that the requirement is subject to group specificities. Respondents who want to remove the national discretion completely mention that different capital calculations may dilute comparability between institutions on a stand alone basis. Respondents who want to transform the national discretion into a general rule mention that there is no "double gearing" within a group, level playing field and cross border considerations, the common treatment across Member States, the potential impact of deletion and the pointlessness of having two contradictory approaches. Furthermore, when institutions are subject to supervision on a consolidated basis, there is no need to deduct the participations. Industry respondents favour transforming the national discretion into a general rule as the requirement has an impact on the setting up of group structures and helps the maintenance of centralised functions. Consistent application would avoid competitive distortions. 6 of these respondents chose the option for credit

institutions in the format "Credit institutions […] need not deduct" which answers were regrouped to "remove, b)" in the original analysis.

4. **Impact on business:** Expectations of the impact resulting from divergent exercise of the discretion are split; 8 expect an impact; 2 just a minor impact and 7 do not expect any impact.

5. **Possible solution:** There are contradictory supervisory positions both on content and on impact (i.e. "Individual firms, rather than groups, have obligations to consumers and this is the fundamental reason for setting solo prudential requirements" versus "When institutions are subject to supervision on a consolidated basis, there is no need to deduct the participations"). Though it is noted that the industry favours giving the institutions the option, this subject should be dealt with in the context of the expected general review of the definition of own funds. The proposal on this discretion is **to keep it as it is pending the review of the definition of own funds**.

6. **Drafting proposal:** No change necessary.

5. Own Funds, Articles 61, 63.1, 64.3 and 65 (Directive 2006/48/EC)

"61. The concept of own funds as defined in points (a) to (h) of Article 57 embodies a maximum number of items and amounts. The use of those items and the fixing of lower ceilings, and the deduction of items other than those listed in points (i) to (r) of Article 57 shall be left to the discretion of the Member States.

63.1. The concept of own funds used by a Member State may include other items provided that, whatever their legal or accounting designations might be, they have the following characteristics: […]

64.3. Member States or the competent authorities may include fixed-term cumulative preferential shares referred to in point (h) of Article 57 and subordinated loan capital referred to in that provision in own funds, if […]

65. Where the calculation is to be made on a consolidated basis, the consolidated amounts relating to the items listed under Article 57 shall be used in accordance with the rules laid down in Chapter 4, Section 1. Moreover, the following may, when they are credit ('negative') items, be regarded as consolidated reserves for the calculation of own funds: […]"

Objective of the discretion: This national discretion allows Member States to define the composition of own funds (resulting in a higher or lower level of own funds).

1. **Overview of exercise:** 72% of Member States exercise this national discretion, 21% of Member States with conditions and 7% of Member States state that they do not exercise it.

2. **Overview of responses:** 29 respondents are in favour of keeping the national discretion (of which 24 in the present form), only 7 responses are in

favour of transforming it into a general rule). The national discretion is judged rather important (14 indicate that is very important, 4 important, 12 fairly important; 1 respondent is indifferent and for another it is not relevant).

3. **Main drivers**: Members that want to keep the national discretion mention the current revision of the own funds regime, local specificities (possibility of adjusting the own funds definition based on local conditions and central bank policy), the potential impact of deletion, existing market practice, the dynamics of own funds elements and national specificities (differences in national accounting legislation/standards). Respondents who want to transform the national discretion into a general rule mention common treatment across Member States and the current revision of the own funds regime that should result in greater convergence. Industry respondents who want to keep the national discretion mention the current revision of the own funds regime. It is argued that the current Basel I based regime should be replaced by new, more flexible (principles based) rules. Until then, the discretions should not be changed. However, the existing range of discretions is criticised for reasons of competitive distortions (with regard to limit setting, deduction requirements, minority interests and the transferability of excess capital held in subsidiaries).

4. **Impact on business:** 9 respondents do not expect any impact resulting from divergent exercise of the discretion; 7 do.

5. **Possible solution:** A common definition of own funds is strongly favoured. Until this is available, a change to this national discretion would have large consequences for limited benefit. This subject should be dealt with in the context of the expected general review of the definition of own funds. The proposal on this discretion is **to keep it as it is pending the review of the definition of own funds**.

6. **Drafting proposal:** No change necessary.

6. Own Funds, Article 13.2 (Directive 2006/49/EC)

"By way of derogation from paragraph 1, the competent authorities may permit those institutions which are obliged to meet the capital requirements calculated in accordance with Articles 21 and 28 to 32 and Annexes I and III to VI to use, for that purpose only, an alternative determination of own funds. […]"

Objective of the discretion: This national discretion allows Member States to introduce an alternative method of own funds calculation for certain investment firms.

1. **Overview of exercise:** 47% of Member States exercise this national discretion (3% of Member State with conditions), 34% of Member States are not exercising it and 17% of Member States have not finally decided.

2. **Overview of responses:** 13 respondents are in favour of keeping the national discretion in the present form and 8 respondents would like to turn it

into a discretion for credit institutions, 12 responses are in favour of removing the discretion (of which 5 would prefer to transform it into a general rule);and 3 respondents have no preference .

3. **Main drivers**: Members that want to keep the national discretion as it is mention the current revision of the own funds regime, business specificities, the potential impact of deletion and its importance to certain market players. The respondent who wants to turn the national discretion into a discretion for credit institutions mentions legal continuity. Respondents who want to remove the national discretion completely mention business reasons (equal rules for all financial institutions, "alternative option will give the investment firms a benefit"). Respondents who want to transform the national discretion into a general rule mention that this definition is more in line with the Basel definition of own funds, common treatment, current revision of the own funds regime and the benefits to small investment firms. Industry respondents prefer to transform the national discretion into a discretion for the institutions (investment firms), based on the proportionality principle and competitive equality.

4. **Impact on business:** 9 respondents do not expect any impact resulting from divergent exercise of the discretion and 4 respondents expect an impact on their business (of which 2 expect only a minor impact).

5. **Possible solution:** A common definition of own funds is strongly favoured. Until this is available, a change to this national discretion would have large consequences for limited benefit. This subject should be dealt with in the context of the expected general review of the definition of own funds. The proposal on this discretion is **to keep it as it is pending the review of the definition of own funds**.

6. **Drafting proposal:** No change necessary.

7. Own Funds, Article 13.5 (Directive 2006/49/EC)

"The competent authorities may permit institutions to replace the subordinated loan capital referred to in point (c) of the second subparagraph of paragraph 2 with points (d) to (h) of Article 57 of Directive 2006/48/EC."

Objective of the discretion: To give institutions more flexibility regarding the composition of own funds. If an institution is calculating its own funds in accordance with the alternative offered in Article 13.2 of Directive 2006/49/EC, it can be allowed to substitute subordinated loans with other elements described in Article 57 of Directive 2006/48/EC, mainly as Tier 2. It allows the institution to replace Tier 3 capital with excess Tier 2 capital which cannot be recognised as own funds because of Article 66(1) (a) of Directive 2006/48. The assumption behind this rule is that Tier 2 capital is of better quality than Tier 3 capital. Some Member States do not recognise Tier 3 capital. The origin of the rule is the Basel market risk amendment of 1996).

1. **Overview of exercise**: The information available is not fully consistent. According to the supervisory disclosure framework 30% of Member States have exercised the discretion, 56% have not. However, according to an earlier survey, nearly 50% of Member States have exercised this national discretion.

2. **Overview of responses**: 11 respondents would like to keep the option in the current form and 8 would prefer to give it to credit institutions (of which 6 respondents from the industry). 8 respondents would like to remove it; 3 would like to transform it into a general rule; and 9 of the respondents have no preference. The weighting of importance is quite equally distributed with a bias to fairly important or indifferent.

3. **Main drivers**: The main argument for keeping it is that it should be left until the revision of the own funds rules takes place. The main arguments for removal are level playing field issues.

4. **Impact on business**: Nearly all respondents assume that there would be no or only limited impact on business resulting from divergent exercise of the discretion. 1 respondent expects that domestic firms would be less competitive against foreign firms which can use the option.

5. **Possible solution:** Against the background that the national discretion on the one hand allows a more flexible treatment for institutions but on the other hand is prudentially no less conservative, it could be proposed to leave the discretion to institutions rather than to supervisors. Cross border implications are limited and the impact on credit institutions and investment firms is none or very limited; for countries which allow Tier 3 to support short-term trading-book risk, it does not make sense to disallow this option. The proposal is to change the national discretion into an **option for institutions**. This would not change the treatment in Member States which have decided not to recognise Tier 3 capital components. As the definition of capital will be reviewed in the coming years, one could argue for waiting for this revision. However, leaving the choice to the institutions does not change the capital definition as such.

6. **Drafting proposal**:

Institutions may substitute the subordinated loan capital referred to in point (c) of the second subparagraph of paragraph 2 with points (d) to (h) of Article 57 of Directive 2006/48/EC.

8. Own Funds, Article 14 (Directive 2006/49/EC); 14(1) for investment firms, 14 (2) for credit institutions

"The Competent Authorities may permit investment firms to exceed the ceiling for subordinated loan capital set out in Article 13(4) if they judge it prudentially adequate and provided that (…)

The competent authorities may permit the ceiling for subordinated loan capital set out in Article 13(4) to be exceeded by a credit institution if they judge it prudentially adequate and provided that (…)"

Objective of the discretion: More generous rule, extension of the capital base of credit institutions and investment firms, permitting them to hold subordinated capital (Tier 3) in excess of ordinary thresholds, up to certain limits.

1. **Overview of exercise**: 36% of Member States have exercised the discretion, 43% have not.

2. **Overview of responses:** 13 respondents would like to keep the discretion in its present form; 5 would like to remove it; and 5 to transform it into a general rule. 8 have no preference. Importance is in evenly distributed: the industry assigns the provision more importance than the Members do.

3. **Main drivers**: The main argument given in favour of keeping it is that it should be left until the revision of the own funds rules takes place. The main arguments for removal concern level playing field issues.

4. **Impact on business**: Nearly all respondents assume that there would be no or only limited impact on business resulting from divergent exercise of the discretion. 1 respondent fears that domestic firms would be less competitive against foreign firms which can use the option.

5. **Possible solution**: Against the background of the split positions of Members and the fact that the revision of the own funds rules is on the horizon, it would probably be best to leave the content of this discretion as it is. The provision has level playing field implications because credit institutions which can use the option have a broader capital base available. The application is dependent on whether it is prudentially adequate for the specific institution and other criteria are fulfilled. This presupposes supervisory judgement on a case by case basis, which is also the way the provision is phrased, though in practice not the way it was implemented in all Member States in domestic law. As this provision **is not intended to be a national discretion, but a supervisory decision** to be applied on a case by case basis it should have been implemented and applied as such in all Member States (the provision says "the competent authority may allow" and not the Member State). The text from the Directive should be kept unchanged and the Member States that have not yet implemented this provision as a supervisory decision to be used on a case by case basis should be urged to do so as soon as possible.

6. **Drafting proposal:** No change necessary at the CRD level, but the provision should be implemented as a supervisory decision at the national level.

7. **Other remarks**: The CEBS supervisory disclosure framework should differentiate between Article 14(1) (which concerns investment firms) and Article 14(2) (which concerns credit institutions).

Area: Scope of Application

9. Scope of application, Article 69.1 (Directive 2006/48/EC)

"The Member States may choose not to apply Article 68(1) to any subsidiary of a credit institution, where both the subsidiary and the credit institution are subject to authorisation and supervision by the Member State concerned, and the subsidiary is included in the supervision on a consolidated basis of the credit institution which is the parent undertaking, and all of the following conditions are satisfied, in order to ensure that own funds are distributed adequately among the parent undertaking and the subsidiaries: (…)"

Objective of the discretion: Enables a reduction in the regulatory burden on banking groups by partially waiving the prudential requirements on a solo basis.

1. **Overview of exercise:** Currently 40% of Member States exercise the discretion and 60% of Member States do not.

2. **Overview of responses**: 12 respondents favoured keeping the national discretion in its present form, 7 as a discretion for supervisors, 3 subject to mutual recognition and 1 as an option for credit institutions. 10 preferred to remove the discretion completely and 4 to transform it into a general rule. 7 respondents had no preference. In particular industry's respondents supported either keeping the discretion in its present form or transforming it into a general rule. The discretion was generally considered to be important both for the Members and for industry's respondents (12 of the respondents stating it is very important, 5 important, and 9 fairly important). 17 respondents are indifferent or find the national discretion not relevant.

3. **Main drivers**: The main motivation for keeping the waiver was the flexibility it provides in order to reduce the supervisory burden in situations where consolidated supervision can justifiably substitute for supervision on a solo basis. Respondents who supported the removal of the discretion were of the opinion that there should be no exemptions from meeting the prudential requirements.

4. **Impact on business**: Only a few respondents felt that a possible divergence in exercising the discretion would have any business impact.

5. **Possible solution:** The impact of divergence is considered to be immaterial. The discretion has no cross-border implications and no impact on the level playing field. The discretion furthermore provides necessary flexibility for the implementation of the CRD and is closely linked with domestic insolvency rules and depositor protection rules. Also, keeping the discretion was supported by both the supervisors and industry. A revision would also impact on the existing compromise on the scope of application and should therefore only be done in the context of a full review of the subject. The national discretion should be **kept in its present form**.

6. **Drafting proposal:** No change necessary.

10. Scope of Application, Article 69.3 (Directive 2006/48/EC)

"The Member States may choose not to apply Article 68(1) to a parent credit institution in a Member State where that credit institution is subject to authorisation and supervision by the Member State concerned, and it is included in the supervision on a consolidated basis, and all the following conditions are satisfied, in order to ensure that own funds are distributed adequately among the parent undertaking and the subsidiaries: (…) The competent authority which makes use of this paragraph shall inform the competent authorities of all other Member States."

Objective of the discretion: Enables reduction of the regulatory burden on the banking groups by partially waiving the prudential requirements on a solo basis.

1. **Overview of exercise:** Currently, 20% of Member States exercise the discretion and 80% Member States do not.

2. **Overview of responses**: 12 respondents favoured keeping the national discretion in its present form, 5 would prefer keep it as a discretion for supervisors, 1 subject to mutual recognition and 1 as an option for credit institutions). 12 preferred to remove it completely and 4 to transform it into a general rule. 8 respondents had no preference. In particular, industry's respondents equally supported either keeping the discretion in its present form or transforming it into a general rule. In general, the discretion was considered to be rather important (10 respondents stating it was very important, 6 important and 7 fairly important). 7 respondents are indifferent and for 13 this discretion is not relevant.

3. **Main drivers**: Flexibility and market/legal specificities were pointed out as the main reasons for keeping the discretion. Favouring the transformation into a general rule was explained in terms the existing internal structures of banking groups and the notion that the CRD should be applied at the highest level of banking groups. Respondents who supported the removal of the discretion completely were of the opinion that there should be no exemptions from meeting the prudential requirements.

4. **Impact on business**: Only a few respondents felt that a possible divergence in exercising the discretion would have any business impact.

5. **Possible solution**: The impact of divergence is immaterial. The discretion has no cross-border implications and no impact on the level playing field, and keeping the discretion was supported by both the supervisors and industry, The discretion provides necessary flexibility for the implementation of the CRD and is closely linked with national tax regimes, insolvency rules and depositor protection rules. A revision would also impact the existing compromise on the scope of application and should therefore only be done in the context of a full review of the subject. The national discretion should be **kept in its present form**.

6. **Drafting proposal:** No change necessary.

11. Scope of application, Article 70 (Directive 2006/48/EC)

"Subject to paragraphs 2 to 4 of this Article, the competent authorities may allow on a case by case basis parent credit institutions to incorporate in the calculation of their requirement under Article 68(1) subsidiaries which meet the conditions laid down in points (c) and (d) of Article 69(1), and whose material exposures or material liabilities are to that parent credit institution. (…)"

Objective of the discretion: Enables the reduction of the regulatory burden on the credit institutions by partially modifying the prudential requirements on a solo basis.

1. **Overview of exercise**: Currently, 33% of Member States exercise the discretion (3% of Member States with a proviso) and 63% of Member States do not exercise the discretion.

2. **Overview of responses**: 11 respondents favoured keeping the national discretion in its present form, 9 as a discretion for supervisors, 1 subject to mutual recognition and 3 as an option for credit institutions. 7 preferred to remove it completely and 2 to transform it into a general rule. 10 had no preference. In particular industry respondents generally favoured keeping the discretion in its present form. The discretion was generally considered to be moderately important (9 respondents stating it was very important, 6 important 7 fairly important, 7 indifferent and 14 not relevant).

3. **Main drivers**: Respondents who supported keeping the waiver pointed out that allowing solo consolidation may be justified in some circumstances. As a reason for removing the discretion, a number of respondents pointed out that the discretion is not relevant in their market.

4. **Impact on business**: Most of the respondents were of the opinion that possible divergence in the exercise of the discretion would not have any business impact.

5. **Possible solution**: Since possible divergence was not seen as an issue and it mostly concerns the non-supervised entities within a group, there is no apparent need to remove the discretion. The discretion provides necessary flexibility for the implementation of the CRD and is closely linked with national tax regimes, insolvency rules and depositor protection rules. A revision would also impact the existing compromise on the scope of application and should therefore only be done in the context of a full review of the subject. As this provision **is not intended to be a national discretion, but a supervisory decision** to be applied on a case by case basis that should have been implemented and applied as such in all Member States (the provision says "the competent authority may allow on a case by case basis"). The text from the Directive should be kept unchanged and the Member States that have not yet implemented this provision as a supervisory decision to be used on a case by case basis should be urged to do so as soon as possible.

6. **Drafting proposal:** No change necessary at the CRD level, but the provision should be implemented as a supervisory decision at the national level.

12. Scope of application Article 72.3 (Directive 2006/48/EC)

"The competent authorities responsible for exercising supervision on a consolidated basis pursuant to Articles 125 and 126 may decide not to apply in full or in part paragraphs 1 and 2 to the credit institutions which are included within comparable disclosures provided on a consolidated basis by a parent undertaking established in a third country."

Objective of the discretion: Enables the reduction of the regulatory burden on the banking groups.

1. **Overview of exercise**: Currently 50% of Member States exercise the discretion (7% of Member States with a proviso) and 43% of Member States do not exercise the discretion.

2. **Overview of responses**: 11 respondents favoured keeping the national discretion in its present form, 6 as a discretion for supervisors and 1 subject to mutual recognition. 7 respondents preferred to remove the discretion completely and 10 to transform it into a general rule. 8 respondents had no preference. In particular respondents from the industry favoured removing the discretion by transforming it into a general rule. Overall the majority of the respondents favoured keeping the discretion. The discretion was generally considered to be fairly important (3 respondents stating it was very important, 3 important, 14 fairly important, 8 indifferent and 15 not relevant).

3. **Main drivers**: The main motivation for keeping the discretion was the recognition of a group-wide approach while ensuring sufficient disclosure. The argument for removing the discretion was the lack of need for this discretion. The main motivation for removing the discretion by transforming it into a general rule was to apply Pillar 3 only at a consolidated level.

4. **Impact on business**: Most of the respondents were of an opinion that a possible divergence in exercising the discretion would not have any business impact.

5. **Possible solution:** Seeing that the presence of subsidiaries of third country credit institutions with equivalent disclosure requirements is rather limited, the impact of divergence cannot be considered substantial. In fact this provision **is not intended to be a national discretion but a supervisory decision** to be applied on a case by case basis that should have been implemented in this way by all Member States (the provision says "the competent authority… may decide" and not the Member State). It should also be applied as such. The text from the Directive should be kept unchanged and the Member States that have not yet implemented this provision as a supervisory decision to be used on a case by case basis should be urged to do so as soon as possible. Such implementation will not impact on the current state of play regarding the scope of application.

   Although it could be possible to agree on criteria for the assessment of comparability for Pillar 3 disclosures, this would imply going through full equivalence assessments. The burden and costs of this process (directly for the supervisors and thus in most Member States indirectly for the industry and/or the state) would be likely to outweigh the benefits from the eventual removal of the subjectivity in this supervisory decision regarding comparability. However, the competent authorities who are in similar positions vis-à-vis third countries should consult each other to ensure a harmonised approach.

6. **Drafting proposal:** No change necessary at the CRD level, but the provision should be implemented as a supervisory decision at the national level, the exercise of which could usefully be based on discussions between the competent authorities involved.

13. Scope of application, Article 73.1 (Directive 2006/48/EC)

"The Member States or the competent authorities responsible for exercising supervision on a consolidated basis pursuant to Articles 125 and 126 may decide in the following cases that a credit institution, financial institution or ancillary services undertaking which is a subsidiary or in which a participation is held need not be included in the consolidation: (…)"

Objective of the discretion: The national discretion allows Member States to determine the scope of the group for the purposes of consolidation.

1. **Overview of exercise:** Currently 77% of the Member States exercise the discretion (17% with a proviso) and 7% of the Member States do not exercise the discretion.

2. **Overview of responses**: 12 respondents favoured keeping the national discretion in its present form, 6 as a discretion for supervisors and 7 as option for credit institutions. 1 respondent preferred to remove the discretion completely and 9 to transform it into a general rule. 7 respondents showed no preference. In particular, the industry strongly favoured keeping the discretion as an option for credit institutions. The discretion was generally considered to be important (5 of the respondents stating it was very important, 9 important, 13 fairly important, 3 indifferent and 12 not relevant).

3. **Main drivers**: Keeping the discretion was motivated by business and market specificities which require flexibility. Proposals to remove the discretion by transforming it into a general rule were motivated by the need to stipulate more detailed principles for exemption.

4. **Impact on business**: Most of the respondents were of an opinion that a possible divergence in exercising the discretion would not have a significant business impact.

5. **Possible solution**: The discretion is widely exercised by Member States and the majority of respondents favoured keeping the discretion. The proposal is to **transform it into a supervisory decision** to be applied on a case by case basis by deleting the alternative allocation of this option to the Member State.

Competent authorities can then clarify which types of institutions need not be included in the consolidation. Since most of the criteria referred to in Article 73.1 are subject to interpretation, CEBS's view is that only the competent authorities are in position prudently to interpret and assess the application of these criteria against their supervisory objectives. This technical change will not impact the current state of play regarding the scope of application.

6. **Drafting proposal:**

<u>The competent authorities</u> responsible for exercising supervision on a consolidated basis pursuant to Articles 125 and 126 may decide in the following cases that a credit institution, financial institution or ancillary services undertaking which is a subsidiary or in which a participation is held need not be included in the consolidation: (…)

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

"22(1) The competent authorities required or mandated to exercise supervision of groups covered by article 2 on a consolidated basis may waive, on a case by case basis, the application of capital requirements on a consolidated basis provided that (specific conditions related to investment firms…)

22(2)By way of derogation from paragraph 1, competent authorities may permit financial holding companies which are the parent financial holding company in a Member State of an investment firm in such a group to use a value lower than the value calculated under (…)

24(1) By way of derogation from Article 2(2), competent authorities may exempt investment firms from the consolidated capital requirements (…)

25 (1) By way of derogation from Article 2(2), competent authorities may exempt investment firms from the consolidated capital requirement (…)"

Objective of the discretion: Competent authorities may exempt investment firms, on a case by case basis, from the consolidated capital requirements provided that all the investment firms in the group meet certain conditions. The national discretion provides for a proportionate approach to capital requirements for groups consisting of investment firms with limited activities and/or licences.

1. **Overview of exercise**: Currently, 27% of the Member States exercise the discretion (7% with a proviso), 46% of the Member States do not exercise the discretion. The discretion was not applicable in 17% of Member States.

2. **Overview of responses**: 10 respondents favoured keeping the national discretion in its present form and 5 as a discretion for supervisors. 7 respondents preferred to remove the discretion completely and 5 to transform it into a general rule. 16 respondents had no preference. In particular, the industry respondents preferred removing the discretion by transforming it into a general rule. Overall the majority of respondents had no preference

regarding the discretions. With a few exceptions, the discretion was mostly considered to be of little importance (4 respondents stating it was very important, 3 important, 7 fairly important, 7 indifferent and 22 not relevant).

3. **Main drivers**: Keeping the discretion was motivated by business and market specificities which require flexibility. The main reason given in support of removing the discretion was the practical insignificance of the discretion.

4. **Impact on business**: Most of the respondents were of the opinion that a possible divergence in exercising the discretion would not have any business impact.

5. **Possible solution**: In respect of the present discretion, there are essentially three separate discretions that should be grouped as follows:

    a. Article 22 should be correctly classified as a supervisory decision. In fact this provision **is not intended to be a national discretion, but a supervisory decision** (the provision says "the competent authority… may waive on case by case basis" and not the Member States) to be applied on a case by case basis which should have been implemented in this way by all Member States. Indeed, Article 22 already explicitly includes the case by case provision. It should also be applied as such. The text from the Directive should be kept unchanged and the Member States that have not yet implemented this provision as a supervisory decision to be used on a case by case basis should be urged to do so as soon as possible. Such implementation will not impact on the current state of play regarding the scope of application. Article 22 is intended to allow a proportional approach to the limited licence and limited activity investment firms within its scope.

    b. However, Articles 24 and 25 specify how to apply own funds at the consolidated level for investment firm groups where the discretion (to 'waive' consolidation) in Article 22 has not been exercised. These provisions are designed to provide for a more appropriate and proportionate approach for dealing with the risk within groups that consist of limited licence and/or limited activity investment firms. This reflects application of a fixed overheads requirement rather than an operational risk charge for limited licence or limited activity investment firms as a basis to help ensure an orderly wind-down in the event of problems. The three paragraphs in Articles 24 and 25 can be replaced by a proportionate application of the own funds requirements laid down in Article 20 of Dir 2006/49/EC by giving the **option for investment firms**. Such proportionate implementation will not impact on the current state of play regarding the scope of application.

6. **Drafting proposal:** Articles 22: no change necessary at the CRD level, but the provision should be implemented as a supervisory decision at the national level. Proposal for Articles 24 and 25:

Article 24:

24 (1). By way of derogation from Article 2(2), where all the investment firms in the group are covered by Article 20(2) and the group does not include credit institutions, the investment firms in the group may choose not to apply the consolidated capital requirement established in Article 2(2) provided that the requirements of Article 24(2) or Article 24(3) are met instead.

24 (2). Where the option in paragraph 1 is exercised, a parent investment firm (…)

24 (3). Where the option in paragraph 1 is exercised, an investment firm controlled (…)

Article 25:

By way of derogation from Article 2(2), where all the investment firms in the group fall within the investment firms referred to in Article 20(2) and (3) and the group does not include credit institutions, the investment firms in the group may choose not to apply the consolidated capital requirement established in Article 2(2) provided that the requirements of the second or third paragraph of this Article are met instead."

Where the option in the first paragraph is exercised, a parent investment firm in a Member State (…)

Where the option in the first paragraph is exercised, an investment firm controlled by a financial holding company (...)

Area: Counterparty Risk in Derivatives

15. Counterparty Risk in Derivatives, Annex III, Part 3 (Directive 2006/48/EC) (text above table 2)

"For the purpose of calculating the potential future credit exposure in accordance with step (b) the competent authorities may allow credit institutions to apply the percentages in Table 2 instead of those prescribed in Table 1 provided that the institutions make use of the option set out in Annex IV, point 21 to Directive 2006/49/EC for contracts relating to commodities other than gold within the meaning of paragraph 3 of Annex IV, to this Directive: (table)."

Objective of the discretion: For institutions complying with certain requirements in their trading activities in commodities, gold and other products, competent authorities may allow percentages for the calculation of potential future value other than the general ones. The discretion allows for a larger degree of differentiation (capital requirements) with respect to specific commodity categories. However, it leads in all cases to lower capital requirements for these categories.

1. **Overview of exercise**: 33% of the Member States exercise this discretion; 67% have not exercised the discretion.

2. **Overview of responses**: 9 respondents would like to keep the possibility of choosing between the two options, another 10 have no preference and 18 are in favour of getting rid of it, either by removing it from the Directive or by transforming it into a general rule. However, for most respondents who would like to keep the option, the option itself is not so important.

3. **Main drivers**: Respondents who are in favour of getting rid of the discretion argue that the Directive now provides two additional, more risk sensitive possibilities and therefore, that it is not necessary to keep this out-dated option. Respondents who favour keeping the discretion argue mainly on the basis of "market specificities".

4. **Impact on business**: The vast majority of respondents assume that there would be no impact on business resulting from a divergent exercise of this discretion.

5. **Possible solution**: On the one hand the provision provides for a larger degree of differentiation between different products. On the other hand the specified treatment leads in all cases to lower capital requirements. However, authorisation to use the proposed treatment is only possible if an institution meets the criteria in Annex IV, point 21 of the CAD which are: a) to undertake significant commodities business, b) to have a well diversified portfolio and c) not yet to be in a position to use internal models. Therefore, this can probably be justified by the assumptions that the requirements for such institutions to have a) significant commodity business and b) a well diversified portfolio, should help them with understanding and managing the prudential risk. Nevertheless, there is still the question of whether an institution with significant commodities business should not be using an internal model for the calculation of capital requirements. This is probably not the case for smaller institutions. Therefore, the deletion of the discretion could be a disadvantage for smaller institutions but with significant commodities business and which are well diversified. Leaving the choice to the discretion of credit institutions seems not to be an option because we are talking about a less prudent treatment which leads to lower capital requirements. Mutual recognition also seems not to be an option because it would not really help alleviate the possible downside of this discretion. The cross border implications are limited as large international institutions are expected to use internal models and no implications for regional markets are foreseen. The discretion is apparently not used by larger institutions. Taking into account the pros and cons and considering that this discretion allows supervisors to deal with small commodities firms in a proportionate way, the proposal is to **keep the discretion as it is**, subject to any relevant findings of the Joint CEBS-CESR Commodities Task Force.

6. **Drafting proposal**: No change necessary.

16. Counterparty Risk in Derivatives, Annex III, Part 6, point 7 (Directive 2006/48/EC)
"(…) alpha (α) shall be 1.4, but competent authorities may require a higher α (…)"

Objective of the discretion: Possibility for a supervisor (on a case by case basis) to require higher capital requirements (exposure values) depending on the risk characteristics of a firm's portfolio.

1. **Overview of exercise**: 60% of Member States use this discretion.

2. **Overview of responses**: 16 respondents are in favour of continuing to allow supervisors to require a higher alpha, either by keeping the discretion in the present form or as a case by case supervisory decision. Institutions active cross-border are however of the opinion that the discretion should be deleted. Regarding importance, views are split. For half of the respondents this provision is important, for the other half it is not.

3. **Main drivers**: Most supervisors argue that it is important to maintain the possibility of adjusting alpha according to the risk characteristics of the institution. The industry argues that this discretion unduly penalises institutions subject to stricter supervisors.

4. **Impact on business:** All respondents assume that there would be no or limited impact on business resulting from divergent exercise of the discretion.

5. **Possible solution**: According to the general provision in Annex III, Part 6, point 1("Subject to the approval of the competent authorities, a credit institution may use the Internal Models Method…") it would still be for supervisors to decide whether specific portfolios do require alphas higher than 1.4. This discretion is in fact **part of the overall supervisory approval process for the model**. However the provision could be amended to make clear that the amount of alpha would be a case by case decision which will be taken in the overall context of the model approval taking into account the characteristics of the portfolio of the firm (instead of requiring a stand alone decision on one component of the model). A separate explicit approval of alpha is not necessary. Cross border implications are limited or none. According to evidence provided by ISDA for portfolios of large international firms, normally an alpha of 1.4 would be sufficient. Higher alphas were primarily provided for smaller firms with less diversified portfolios.

6. **Drafting proposal**:

(…) alpha (α) shall be not less than 1.4 (…)

17. Counterparty Risk in Derivatives, Annex III, Part 6, point 12 (Directive 2006/48/EC)

"Notwithstanding point 7, competent authorities may permit credit institutions to use their own estimates of α, subject to a floor of 1, 2 (…)"

Objective of the discretion: Possibility for credit institutions to apply an even more advanced modelling approach.

1. **Overview of exercise:** The majority (77%) of Member States have exercised this discretion.

2. **Overview of responses:** The preferences seem to be split. However, taking into account the nature of this discretion, i.e. to allow credit institutions the use of internal estimates of alpha or not, the general opinion of most Members is that it should be kept in the hands of the supervisors to decide whether credit institutions can use internal estimates of alpha or not (the industry has the opposite view). For half of the respondents the discretion is somewhat important, for the other half not.

3. **Main drivers**: Most respondents emphasise that there must be flexibility for institutions to use or not to use their own estimates.

4. **Impact on business**: Industry emphasises that they should have the choice of calculating alpha internally or not.

5. **Possible solution**: The use of internal estimates of alpha is **part of the supervisory approval process of the model.** The main interest of supervisors is to decide if an institution is able to calculate alpha internally or not, and this decision will be taken during the model approval process. As Annex III, Part 6 point 1 Dir. 2006/48/EC already determines that credit institutions may use the Internal Models Method only with prior approval by their competent authorities and as the decision on whether internal estimates of alpha can be used is already included into this approval process an explicit approval of alpha is not necessary. The provision can be amended to clarify that it is part of the model approval process.

6. **Drafting proposal**:

Notwithstanding point 7, <u>subject to the approval of competent authorities credit institutions may</u> use their own estimates of α, subject to a floor of 1.2, where α shall equal the ratio of internal capital from a full simulation of CCR exposure across counterparties (numerator) and internal…

18. Counterparty Risk in Derivatives, Annex III, Part 7c (ii) (Directive 2006/48/EC)

"- NGR = 'net to gross ratio': at the discretion of the competent authorities, either: (i) separate calculation: (…) or (ii) aggregate calculation: (…)

If Member States permit credit institutions a choice of methods, the method chosen is to be used consistently."

Objective of the discretion: The national discretion allows for a choice between two calculation methods when calculating the 'net-to-gross ratio'.

1. **Overview of exercise**: The data on the exercise of this national discretion are less than clear, as 'exercised' can mean different things to different

respondents. However, 23% of Member States have explicitly stated that they allow a choice, 23% that they do not.

2. **Overview of responses**: The preferences of Members and industry respondents are split. 7 respondents have no preference, 16 are in favour an option for credit institutions, 6 would like to keep it in the present form, and 6 to change it into a general rule. For the majority of the respondents the importance of the discretion is low. Industry regards it as more important, supervisors less so.

3. **Main drivers**: The respondents who want to change the discretion into an option for credit institutions indicate that credit institutions should not be forced to implement tools only for supervisory purposes, and that the rule of proportionality should apply. The respondents who want to keep the discretion indicate that they need more time to analyse the impacts of the two possibilities, and that supervisors should have the choice between the two methods. The respondents who want to delete the discretion indicate that the second option is not adequate for prudential purposes, as well as having level playing field concerns.

4. **Impact on business**: All respondents assume that there would be no or limited impact on business resulting from divergent exercise of the discretion.

5. **Possible solution**: Although the majority of respondents would prefer to leave the choice to credit institutions, the separate calculation is more risk sensitive and should therefore be preferred. Additionally the burden of implementation of each of the options seems to be equal. This leaves two options: (a) the less risk sensitive option should be deleted, or (b) the possibility of deciding which method may be used should remain in the hands of supervisors. The more risk sensitive approach is proposed, as a result of which the **possibility of using the aggregate calculation should be deleted**.

6. **Drafting proposal**: Deletion of the sentence "If Member States permit credit institutions a choice of methods, the method chosen is to be used consistently" and rewording the definition of NGR as follows:

"- NGR = '*net-to-gross ratio': the quotient of the net replacement cost for all contracts included in a legally valid bilateral netting agreement with a given counterparty (numerator) and the gross replacement cost for all contracts included in a legally valid bilateral netting agreement with that counterparty (denominator)."*

7. **Other remarks:** The wording of the national discretion is not consistent. The introductory sentence reads: "at the discretion of the competent authorities", the sentence after the discretion reads: "If Member States permit…"

Area: Standardised approach for credit risk

19. Standardised approach, Article 80.3 and Annex VI, Part 1, Point 24 (Directive 2006/48/EC)

"For the purposes of calculating risk-weighted exposure amounts for exposures to institutions, Member States shall decide whether to adopt the method based on the credit quality of the central government of the jurisdiction in which the institution is incorporated or the method based on the credit quality of the counterparty institution in accordance with Annex VI".

Objective of the discretion: This national discretion allows Member States to choose between two methods for the purpose of calculating the capital charge for exposures to institutions.

1. **Overview of exercise:** Members States are equally divided in their use of each of the methods.

2. **Overview of responses:** 19 Members want to keep this national discretion (16 in the present form, 1 for the supervisor to decide on a case by case basis, 2 subject to mutual recognition). 10 Members want to remove it (9 to transform it into a general rule, 1 to remove it completely). 21 Members think that this national discretion is very important or important. On the industry side, 3 respondents (out of 8) want to keep the national discretion in its present form and 5 respondents want to remove it and transform it into a general rule. 4 respondents (out of 5) from the industry think that this national discretion is very important or important. Mutual recognition or removing one of the two options is mentioned by several Members. The removal of option b (after a transition period or immediately) is mentioned by all industry respondents that have made any comment on this question, but the Membership is more equally divided.

3. **Main drivers**: Members who want to keep the national discretion mention market specificities, that this national discretion is one of the "fundamental" Basel options and refer to the low penetration of ratings. Members who want to remove the national discretion mention convergence. Members who want option (a) as a general rule mention the low penetration of ratings. Members who want option (b) as a general rule mention their preference for a more risk sensitive and a more conservative treatment of institutions. Many industry respondents who want one of the two options as a general rule mention that they prefer a choice for the "sake of convergence". Some respondents state the low use of ratings for the majority of banks as a reason for just wanting option (a).

4. **Impact on Business**: A few Members think that this national discretion has high impact. The impact on cross-border groups is mentioned by a few Members and also that it creates level playing field problems. Very few industry respondents have given any comment on the impact on business of this national discretion. One respondent say that the risk weighting of covered bonds differs widely within the EU. One respondent from the industry indicates that it has no impact.

5. **Possible solution**: The method based on the credit quality of the counterparty is more risk sensitive than the method based on the credit

quality of the central government. In that respect it is more in line with the idea behind "Basel II". However in many Member States only a small minority of institutions are externally rated. Consequently the majority of institutions will get the same risk weight regardless of their credit quality. Institutions in such Member States will be put at disadvantage if the method based on the credit quality of the central government is removed. As a result of these considerations, Members have very different opinions regarding the two methods based on their national market specificities. CEBS has considered as a possible solution adding a mutual recognition clause, however its opinion is that this would lead to regulatory arbitrage because there is no clear indication of which competent authority is in the best place to assess the choice of methods. As long as the use of external ratings has not become an EU-wide market standard, Member States are strongly committed to the choice made by them in their own jurisdiction. As therefore the issue cannot be solved at the technical level, the proposal is **to keep the national discretion in its current form**.

6. **Drafting proposal**: No change necessary.

20. Standardised approach, Article 80.7 (Directive 2006/48/EC)

"With the exception of exposures giving rise to liabilities in the form of the items referred to in paragraphs (a) to (h) of Article 57, competent authorities may exempt from the requirements of paragraph 1 of this Article the exposures of a credit institution to a counterparty which is its parent undertaking, its subsidiary, a subsidiary of its parent undertaking or an undertaking linked by a relationship within the meaning of Article 12(1) of Directive 83/349/EEC, provided that the following conditions are met (...)" (amongst which the condition that the counterparty is established in the same Member State as the credit institution).

Objective of the discretion: This discretion allows a more permissive treatment of certain exposures within a Member State if conditions are met.

1. **Overview of exercise:** 70% of Member States exercise the discretion (10% with provisos); 30% do not exercise it.

2. **Overview of responses**: 16 Members want to keep this national discretion (10 in its present form, 4 for the supervisor to decide on a case by case basis, 2 as an option for credit institutions). 12 Members want to remove it (3 remove completely, 1 remove after a transition period, and 8 transform into a general rule). 1 Member has no preference. 18 Members think that this national discretion is very important or important. 4 (out of 9) industry respondents want to keep it in the present form and 5 industry respondents want to remove it and transform it into a general rule. 4 (out of 6) respondents from the industry think that this national discretion is very important or important. When discussing this national discretion, some Members indicate that in their opinion it is, and should remain, at the discretion of the competent authorities not to exercise this discretion on a case by case basis, but instead to decide on a general basis not to permit

institutions in their jurisdiction to exempt exposures to group entities in that same jurisdiction, creating a level playing field domestically. Some Members mention mutual recognition and transforming the national discretion into a general rule. Respondents from the industry who want to remove the national discretion suggest a modified wording ("subject to the relevant conditions (...) exposures (...) shall be assigned a 0% risk weight".).

3. **Main drivers**: Members that want to keep the national discretion mention that supervisors need to decide on a case by case basis and they refer to market and business specificities. Members that want to remove the national discretion also mention market and business specificities, as well as convergence, administrative burdens for cross-border groups and that 0% is a proper risk weight if conditions are met. Respondents from the industry who want the waiver as a general rule think that this national discretion leads to major level playing field distortions. Industry respondents that would like to keep the national discretion mention that the requirement reflects the risk profile within a group so that it "avoids major level field distortions" and that it is part of a political compromise that should not be touched.

4. **Impact on business**: Most Members perceive no impact. A few respondents perceive an impact, for example administrative costs for groups. Most respondents from industry perceive no impact. Impact on groups is mentioned by one respondent.

5. **Possible solution**: Most Members think that it should be possible to exempt, in one way or another, these types of intra-group exposures from the capital charge. In CEBS's view this provision is not intended to be a national discretion but a supervisory decision to be applied on a case by case basis that should have been implemented by all Member States (the provision says "the competent authority may exempt" and not the Member State). The Member States that have not yet implemented this provision should be urged to do so. However as the national discretion have no cross border effects this is not a high priority.

   Furthermore, the Directive text could be changed to clarify that the exemption from the requirements of Article 80 paragraph 1 depends on the **supervisory judgement of the fulfilment of the conditions** as set out in the provision (i.e. if the competent authorities are satisfied that the conditions are met the exemption would be granted to that institution) The conditions set limit the rule to prudentially supervised counterparties in the same Member State. The conditions should be kept, pending changes in similar requirements in the own funds area and similar non-cross-border national discretion in the area of the scope of application. The assessment of whether the transfer of capital is hampered within the jurisdiction is closely linked with the prevailing insolvency and depositor protection rules. Some Member States have expressed their concern that given their legal environment this condition can never be satisfactorily fulfilled and therefore would prefer to retain the possibility to decide on a general basis not to apply the exemption to the institutions in their jurisdiction.

6. **Drafting proposal**:

With the exception of exposures giving rise to liabilities in the form of the items referred to in paragraphs (a) to (h) of Article 57, competent authorities <u>shall</u> exempt from the requirements (…) provided that the following conditions are met (...)

21. Standardised approach, Article 80.8 (Directive 2006/48/EC)

"With the exception of exposures giving rise to liabilities in the form of the items referred to in points (a) to (h) of Article 57, competent authorities may exempt from the requirements of paragraph 1 of this Article the exposures to counterparties which are Members of the same institutional protection scheme as the lending credit institution, provided that the following conditions are met (...)"

Objective of the discretion: This national discretion allows a more permissive treatment of certain exposures if conditions are met

1. **Overview of exercise:** 23% of Member States exercise the discretion; 77% do not exercise it.

2. **Overview of responses**: 10 Members want to keep this national discretion (8 in its present form, 1 for supervisors to decide on a case by case basis, 1 as an option for credit institutions). 12 Members want to remove it (3 remove completely, 5 remove immediately, 3 remove after a transition period, 1 transform into a general rule). 8 Members have no preference. 7 Members think that this national discretion is very important or important. 18 Members are either indifferent or think that this national discretion is not relevant. 2 (out of 7) respondents from the industry want to keep this national discretion (1 in its present form, 1 as an option for credit institutions) and 5 respondents want to remove it (2 remove completely, 3 transform it into a general rule). Out of 3 industry respondents just one thinks that this national discretion is very important. Mutual recognition or setting an expiration date is mentioned by some Members. Industry respondents who want to remove the national discretion suggest that when the criteria set out in Article 80.8 are met, a 0% risk weight should apply.

3. **Main drivers**: Members that want to keep the national discretion mention market specificities, that 0% is a proper risk weight if conditions are met and that a case by case evaluation is needed. Members that want to remove the national discretion mention market specificities, common treatment, that the waiver is not important and the risk of contamination. Just a few comments have been received from the industry side. A few respondents think that this national discretion leads to major level playing field distortions. One respondent who would like to keep the national discretion mentions that it "avoids major level field distortions" and that it is part of a political compromise that should not be touched.

4. **Impact on business**: Members and industry perceive no impact.

5. **Possible solution:** This national discretion is important for those few Members where such institutional protection schemes exist. Other Members and trade body respondents seem to be indifferent to this Article, which can be justified by the non-existence of such institutional protection schemes in a number of Member States. Taking into account that different exercise of this national discretion has limited impact on cross-border business, the national discretion could be kept in its current form. Moreover, this provision is not intended to be a national discretion but a supervisory decision to be applied on a case by case basis that should have been implemented by all Member States (the provision says "the competent authority may exempt" and not the Member State). **This provision should be implemented by all Member States where such schemes exist.**

   Similar to provision number 20, the Directive text could be changed to clarify that the exemption from the requirements of paragraph 1 depends only on the **supervisory judgement of the fulfilment of the conditions** set out in the provision.

6. **Drafting proposal:**

With the exception of exposures giving rise to liabilities in the form of the items referred to in points (a) to (h) of Article 57, competent authorities <u>shall</u> exempt from the requirements of paragraph 1 of this Article the exposures to counterparties which are Members of the same institutional protection scheme as the lending credit institution, provided that the following conditions are met (...)"

22. Standardised approach, Article 83.2 (Directive 2006/48/EC)
"Credit institutions shall use solicited credit assessments. However, with the permission of the relevant competent authority, they may use unsolicited ratings" **Objective of the discretion**: Competent authorities may allow institutions to use unsolicited ratings. This will generally lead to more favourable treatment.

1. **Overview of exercise:** 83% of Member States exercise the discretion (17% with a proviso); 17% do not exercise it.

2. **Overview of responses**: 15 Members want to keep this national discretion (12 in the present form, 2 for supervisors to decide on a case by case basis, 1 subject to mutual recognition). 14 Members want to remove it (2 remove completely, 2 remove after a transition period, 10 transform it into a general rule). 1 Member has no preference. 12 Members think that this national discretion is very important or important, 8 are indifferent and 1 Member thinks that this national discretion is not relevant. 6 (out of 10) respondents from the industry want to keep the national discretion (4 in its present form, 1 subject to mutual recognition, 1 as an option for credit institutions). 4 industry respondents want to remove it (3 remove immediately, 1 transform it into a general rule). 2 (out of 4) industry respondents think that this national

discretion is very important or important. Mutual recognition is mentioned by some Members. Allowing all institutions to use unsolicited ratings and deleting the article are the most common answers from the industry. Mutual recognition and a single EU-wide joint process between supervisors are also mentioned.

3. **Main drivers**: Members that want to keep the national discretion mention the need for case by case permission and market specificities. Members that want the possibility of using unsolicited ratings as a general rule mention the benefits of convergence, of a more risk sensitive framework, the promotion of competition, the reduction of the administrative burden on banks and that only ECAIs approved by supervisors can be used. Industry respondents that want to remove this national discretion mention that both the quality and updating of unsolicited ratings are uncertain. Respondents from the industry who want to keep the national discretion have various arguments, for example that the quality of unsolicited ratings is not necessarily worse than of solicited ratings.

4. **Impact on business**: Most Members and industry respondents perceive no significant impact.

5. **Possible solution**: This provision **is not intended to be a national discretion, but a supervisory decision** to be applied on a case by case basis that should have been implemented by all Member States (the provision says "with the permission of the relevant competent authority" and not the Member State). In principle the text from the Directive should be kept unchanged and the Member States that have not yet implemented this provision should be urged to do so. As regards the exercise of the supervisory decision, competent authorities have different views about the quality of unsolicited ratings that leads to a different exercise of this provision. A change would have a high impact in several markets. Therefore, this supervisory decision should be kept in the current form until such time as a common practice has developed in the markets.

6. **Drafting proposal:** No change necessary at the CRD level, but the provision should be implemented as a supervisory decision at the national level. The Commission could consider simplifying this provision by linking it to the recognition of ECAIs.

Credit institutions shall use solicited credit assessments. However, where the recognition of the ECAI allows the use of unsolicited ratings the credit institutions may use them.

7. **Other remarks:** As noted in 2005/2006 during CEBS's work on the guidelines for the recognition of ECAIs the use of unsolicited ratings raised concerns among several competent authorities resulting in a lack of consensus on the exercise of this discretion. Most competent authorities allow credit institutions to use unsolicited ratings if the ECAI produces only unsolicited ratings, but if the ECAI issues both solicited and unsolicited ratings practices among competent authorities differ.

23. Standardised approach, Annex VI, Part 1, Point. 5 (Directive 2006/48/EC)

"When the competent authorities of a third country which apply supervisory and regulatory arrangements at least equivalent to those applied in the Community assign a risk weight which is lower than that indicated in point 1 to 2 to exposures to their central government and central bank denominated and funded in the domestic currency, Member States may allow their credit institutions to risk weight such exposures in the same manner."

Objective of the discretion: This national discretion allow a more permissive treatment of exposures to central governments and central banks in third countries

1. **Overview of exercise:** 87% of Member States exercise the discretion (7% with a proviso); 13% do not exercise it.

2. **Overview of responses**: 13 Members want to keep this national discretion (8 in its present form, 3 for supervisors to decide on a case by case, 1 subject to mutual recognition, 1 as an option for credit institutions). 16 Members want to remove it and transform it into a general rule and 1 Member has no preference. 11 Members think that this national discretion is very important or important. 14 Members think that it is fairly important. All (8) respondents from the industry want to keep this national discretion subject to mutual recognition. 4 (out of 5) respondents think that this national discretion is very important or important. Mutual recognition or setting up a list of "eligible third countries" is preferred by Members. Most of the industry respondents think that this could be solved through an EU-wide joint process for recognition of third countries.

3. **Main drivers**: Members that want to keep the national discretion mention market specificities, that the assessment of a third country's equivalence must be made on a case by case basis, and competitive equality (i.e. keep national discretion with a mutual recognition clause). Members who want the recognition of a third country's treatment of central government and central bank exposures as a general rule mention the level playing field, reliance on third country authorities, and a more risk sensitive approach, as well as cross-border considerations. All industry respondents that want to keep the national discretion - but subject to mutual recognition - mention level playing field distortion. One respondent that wants to keep the national discretion in the present form thinks that if the supervisory regime is equivalent to supervisory regimes in the EU, decisions of third countries should be accepted.

4. **Impact on business**: Most Members perceive no impact or limited impact. Just one respondent from the industry perceives any impact.

5. **Possible solution**: Although there are different opinions about specific details, most Members agree that it is possible to apply a lower capital charge to exposures to central government and central banks in certain third countries. It would be undesirable if Members have different opinions about whether the "supervisory and regulatory arrangements" in a specific third country are equivalent to those applied in the EU. It is proposed to **transform**

the national discretion into a supervisory decision adding a reference to an **EU joint assessment process** in the context of the CEBS, inviting all interested competent authorities to share information and opinions with the intention of reaching a consensus view, similar to the existing process for ECAIs. The outcome of the joint assessment process could be a public list of eligible third countries that could form a strong common basis on which national competent authorities would form their decisions on the exercise of this supervisory decision. In addition a **non-binding mutual recognition clause** is proposed to promote convergence and also to alleviate the burden of the assessment.

6. **Drafting proposal:**

> *When the competent authorities of a third country which apply supervisory and regulatory arrangements at least equivalent to those applied in the Community assign a risk weight which is lower than that indicated in point 1 to 2 to exposures to their central government and central bank denominated and funded in the domestic currency, <u>competent authorities</u> may allow their credit institutions to risk weight such exposures in the same manner.*
>
> *<u>When the supervisory and regulatory arrangements of a third country need to be evaluated, all relevant competent authorities in the EU shall be invited to participate in a joint assessment. When, as a result of the joint assessment, a competent authority of one Member State subsequently allows their credit institutions to apply a lower risk weight, competent authorities of another Member State may also allow their credit institutions to use a lower risk weight without conducting their own assessment.</u>*

24. Standardised approach, Annex VI, Part 1, Point. 11 (Directive 2006/48/EC)

"When competent authorities of a third country jurisdiction which apply supervisory and regulatory arrangements at least equivalent to those applied in the Community treat exposures to regional governments and local authorities as exposures to their central government, Member States may allow their credit institutions to risk weight exposures to such regional governments and local authorities in the same manner."

Objective of the discretion: This national discretion allows a more permissive treatment of exposures to regional governments and local authorities situated in a third country.

1. **Overview of exercise:** 80% of Member States exercise the discretion (3% with a proviso); 7% do not exercise it.

2. **Overview of responses**: 15 Members want to keep this national discretion (9 in the present form, 4 for supervisors to decide on a case by case basis, 1 subject to mutual recognition, 1 as an option for credit institutions). 15 Members want to remove it and transform it into a general rule. 12 Members think that this national discretion is very important or important; 13 think that

it is fairly important. All (11) industry respondents want to keep this national discretion (3 in its present form, 8 subject to mutual recognition). 4 (out of 5) think that this national discretion is very important or important. Mutual recognition or setting up a list of "eligible third countries" is mentioned by Members. Most of the industry respondents think that this could be solved through an EU-wide joint process for recognition of third countries.

3. **Main drivers**: Members that want to keep the national discretion mention market specificities, that the assessment of a third country's equivalence must be made on a case by case basis, competitive equality (keep with mutual recognition). Members that want the recognition of a third country's treatment of its central government and central bank exposures as a general rule mention the level playing field, reliance on third country authorities, a more risk sensitive approach, as well as cross border considerations. All industry respondents who want to keep the national discretion, but subject to mutual recognition, mention level playing field distortion. One respondent that wants to keep the national discretion in the present form thinks that if the supervisory regime is equivalent to supervisory regimes in the EU decisions of third countries should be accepted.

4. **Impact on business**: Most Members perceive no impact or limited impact. Just one respondent from the industry perceives any impact.

5. **Possible solution**: Although there are different opinions about specific details, most Members seem to agree that it is possible to apply a lower capital charge for exposures to regional governments and local authorities in certain third countries. It would be undesirable if Members have different opinions about whether the "supervisory and regulatory arrangements" in a specific third country are equivalent to those applied in the EU. It is proposed to **transform the national discretion into a supervisory decision** adding a reference to an **EU joint assessment process** in the context of CEBS, inviting all interested competent authorities to share information and opinions, with the intent of reaching a consensus view, similar to the existing joint process for ECAIs. The outcome of the joint assessment process could be a public list of eligible third countries that could form a strong common basis on which national competent authorities would form their decisions on the exercise of this supervisory decision. In addition a **non-binding mutual recognition clause** is proposed to promote convergence and also to alleviate the burden of the assessment.

6. **Drafting proposal**:

When competent authorities of a third country jurisdiction which apply supervisory and regulatory arrangements at least equivalent to those applied in the Community treat exposures to regional governments and local authorities in the same way as exposures to their central government, <u>competent authorities</u> may allow their credit institutions to risk weight exposures to such regional governments and local authorities in the same manner.

<u>When the supervisory and regulatory arrangements of a third country need to be evaluated, all relevant competent authorities in the EU shall be invited to</u>

participate in a joint assessment. When, as a result of the joint assessment, a competent authority of one Member State subsequently allows their credit institutions to treat exposures to third country regional governments and local authorities as exposures to the third country central government, competent authorities of another Member State may also allow their credit institutions this without conducting their own assessment.

25. Standardised approach, Annex VI, Part 1, Point 14 (Directive 2006/48/EC)

"Subject to the discretion of competent authorities, exposures to public sector entities may be treated as exposures to institutions. Exercise of this discretion by competent authorities is independent of the exercise of discretion as specified in Article 80(3). The preferential treatment for short-term exposures specified in points 31, 32 and 37 shall not be applied."

Objective of the discretion: More permissive treatment of exposures to public sector entities.

1. **Overview of exercise:** Currently, 70% of Member States exercise the discretion (7% with a proviso) and 23% of Member States do not exercise the discretion.

2. **Overview of responses**: 19 Members preferred to keep the national discretion (of which: 9 in the present form, 4 for the supervisor to decide on a case by case basis, and 6 subject to mutual recognition). From the industry side, 11 respondents would like to keep the national discretion (of which 2 in its present form, 7 subject to mutual recognition, 2 as an option for credit institutions). 10 Members would prefer to remove the national discretion (9 respondents to transform it into a general rule, 1 Member to remove it immediately from the CRD) and 1 industry respondent would like to remove it completely from the CRD. The national discretion is judged to be very important/important/fairly important by 21 Members and 4 respondents from the industry.

3. **Main drivers**: Members that want to keep the national discretion mention market and institutional specificities, cross-border aspects, supervisory prudence/philosophy, risk specificities of PSEs across Member States (e.g. due to different legal status or guarantee schemes), that the risk weight of PSEs depends on the liability the central government has for the contractual obligations of the entities. Members that want to transform the national discretion into a general rule mention common treatment across Member States/convergence, that the national discretion is applied by the majority of Member States, that the risk of PSEs is similar to that of institutions and thus that the application of a RW of 100% is not adequate.

4. **Impact on business**: 6 Members perceive some level playing field issues, but no or limited impact is mentioned by 9 Members.

5. **Possible solutions**: The treatment of local PSEs in Member States requires local judgement as well as a case by case approach. This provision is not intended to be a national discretion, but a supervisory decision to be applied on a case by case basis that should have been implemented by all Members (the provision says "subject to the discretion of competent authorities" and not the Member States). The text from the Directive should be kept unchanged – a **supervisory decision with the binding mutual recognition clause** included in point 16 - and the Member States that have not yet implemented this provision should be urged to do so (also see provision 27 for non-EU PSEs, and the similar provision 144).

6. **Drafting proposal**: The following wording could be added at the end of the current point 14:

[….] <u>Competent authorities exercising this discretion shall draw up and make public either the criteria used or the list of their public sector entities treated as institutions in the context of the supervisory disclosure framework referred to in Article 144 of this Directive.</u>

26. Standardised approach, Annex VI, Part 1, Point 15 (Directive 2006/48/EC)
"In exceptional circumstances, exposures to public sector entities may be treated as exposures to the central government in whose jurisdiction they are established where in the opinion of the competent authorities there is no difference in risk between such exposures because of the existence of an appropriate guarantee by the central government."
Objective of the discretion: More permissive treatment of exposures to public sector entities if certain conditions are met.

1. **Overview of exercise:** Currently, 67% of Member States exercise the discretion (13% with a proviso) and 20% of Member States do not exercise the discretion.

2. **Overview of responses**: 16 Members would like to keep the national discretion (of which 8 in the present form, 4 for supervisors to decide on a case by case basis, 4 subject to mutual recognition). 10 respondents from the industry share this opinion (of which 2 in the present form, 7 subject to mutual recognition, 1 as an option for credit institutions). 12 Members and 1 respondent from the industry would like to remove the national discretion (of which 9 to transform it into a general rule, 3 to remove it immediately, 1 to remove it completely from the CRD). Mutual recognition is mentioned by the majority of Members. 7 respondents from the industry propose a new wording.

3. **Main drivers**: This national discretion is judged very important/important/fairly important by 21 Members and by 5 respondents from the industry. Members that want to keep the national discretion mention market and institutional specificities, supervisory prudence/philosophy, cross-

border aspects, Member States' risk specificities of PSEs, specificities such as the explicit existence of a contract, the legal regime of the entity, etc. Members that want to transform the national discretion into a general rule mention the common treatment across Member States/convergence, local market conditions and cross-border aspects, and a more risk sensitive approach. Also that the authorities of the third country have a better understanding of local risks, that the national discretion is applied by the majority of Member States, and the consideration that there is no difference in risk if the central government has an unlimited liability for the contractual obligations of the entity and may settle the claims quickly.

4. **Impact on business**: 5 Members perceive a potential impact on business (level playing field issues). 10 Members perceive low/no impact from this national discretion on business.

5. **Possible solution**: The treatment of local PSEs in Member States requires local judgement as well as a case by case approach. This provision **is not intended to be a national discretion, but a supervisory decision** to be applied on a case by case basis that should have been implemented by all Member States (the provision says "in the opinion of the competent authorities" and not the Member States). The text from the Directive should be kept unchanged - with the binding mutual recognition clause included in paragraph 16 - and the Member States that have not implemented this provision should be urged to do so.

6. **Drafting proposal**: The following wording could be added at the end of the current paragraph 15.

… Competent authorities shall draw up and make public either the criteria used or the list of the public sector entities to be risk-weighted like central governments in the context of the supervisory disclosure framework referred to in Article 144 of this Directive.

27. Standardised approach, Annex VI, Part 1, Point 17 (Directive 2006/48/EC)

"When competent authorities of a third country jurisdiction, which apply supervisory and regulatory arrangements at least equivalent to those applied in the Community, treat exposures to its public sector entities as exposures to institutions, Member States may allow their credit institutions to risk weight exposures to such public sector entities in the same manner."

Objective of the discretion: More permissive treatment of exposures to public sector entities of third countries with supervisory/regulatory arrangements at least equivalent to those applied in the Community.

1. **Overview of exercise:** Currently 77% of the Member States exercise the discretion (10% with a proviso) and 13% of Member States do not exercise the discretion.

2. **Overview of responses**: 13 Members would like to keep the national discretion (of which 7 in its present form, 4 for the supervisor to decide on a case by case basis, 1 subject to mutual recognition, 1 as an option for credit institutions). 12 respondents from the industry share the same opinion (of which 5 in the present form, 7 subject to mutual recognition - ensure single EU-wide joint process between supervisors). 15 Members would prefer to transform the national discretion into a general rule. Deciding a common list of "countries with supervisory/regulatory arrangements at least equivalent to those in the Community" and transforming the stated treatment into a general rule is mentioned by 3 respondents. 7 respondents from the industry propose to transform it into a supervisory decision and 5 others would like to have a joint recognition process of third country risks weights, or alternatively an automatic recognition of one EU supervisor's decision in the other EU Member States.

3. **Main drivers**: The national discretion is judged very important/important/fairly important by 23 Members and by 4 respondents from the industry. Members that want to keep the national discretion mention market and business specificities; cross-border related aspects; that Member States should have the possibility of choosing between more/less strict regulation; level playing field aspects; and that the assessment of "equivalence" is made on a case by case basis consistently across EU jurisdictions. Members that want to transform the national discretion into a general rule mention the level playing field across the EU and cross-border considerations; convergence; a more risk sensitive approach: that the authorities of the third country have a better understanding of local risks; if equivalence with supervisory/regulatory arrangements of a Member States is determined, then it should be applied in all Member States; and that the national discretion is applied by the majority of Member States.

4. **Impact on business**: 5 Members perceive some degree of impact on level playing field issues, while 10 Members perceive limited or no impact.

5. **Possible solution**: The treatment of local PSEs in third countries requires local judgement as well as a case by case approach, and can be entrusted to the third country if it has equivalent standards of supervision. In line with the responses to the questionnaire the proposal is to **transform the national discretion into a supervisory decision,** adding to it a **EU joint assessment process** of third countries' to be carried out by all supervisors that wish to participate. If the supervisors reach a consensus view this could subsequently be adopted by competent authorities from all Member States. In addition a **non-binding mutual recognition clause** is proposed to promote convergence and also to alleviate the burden of the assessment. Additionally, the fall back option for third countries which are not deemed equivalent, is the general rule of paragraph 13 (also see provision 83).

6. **Drafting proposal**:

When competent authorities of a third country jurisdiction, which apply supervisory and regulatory arrangements at least equivalent to those applied in the Community, treat exposures to its public sector entities as exposures to

institutions, competent authorities may allow their credit institutions to risk weight exposures to such public sector entities in the same manner.

When the supervisory and regulatory arrangements of a third country need to be evaluated, all relevant competent authorities in the EU shall be invited to participate in a joint assessment. When, as a result of the joint assessment, a competent authority of one Member State subsequently allows their credit institutions to treat exposures to third country public sector entities as exposures to the third country institutions, competent authorities of another Member State may also allow their credit institutions to do this without conducting their own assessment.

28. Standardised approach, Annex VI, Part 1, Point 37 (Directive 2006/48/EC)

"Exposures to institutions of a residual maturity of 3 months or less denominated and funded in the national currency may, subject to the discretion of the competent authority, be assigned, under both methods described in points 26 to 27 and 29 to 32, a risk weight that is one category less favourable than the preferential risk weight, as described in points 4 and 5, assigned to exposures to its central government."

Objective of the discretion: More permissive treatment of short term exposures to Member States' institutions.

1. **Overview of exercise:** Currently 63% of Member States exercise the discretion, (3% with a proviso) and 33% Member States do not exercise the discretion.

2. **Overview of responses:** 9 Members would prefer to keep the national discretion (of which 7 in its present form, 2 for supervisors to decide on a case by case basis); 6 respondents from the industry share this view (of which 2 in the present form, 4 as an option for credit institutions). 17 Members would like to remove the national discretion (of which 10 respondents to transform it into a general rule, 7 respondents to remove it from the CRD) and also 3 respondents from the industry (of which 2 respondents to transform it into general rule, 1 respondent to remove it immediately from the CRD). Mutual recognition is mentioned as a solution by 6 Members, transformation into a general rule by 3 Members, setting an expiry date by 2 Members and removing the option by 1.

3. **Main drivers**: This national discretion is judged very important/important/fairly important by 21 Members and 2 respondents from the industry. Members that want to keep the national discretion mention market and business specificities; the preservation of competitive equality; cross-border aspects; and a better matching to risk profile. Member States should have the possibility of choosing between more/less strict regulation; level playing field and competitive issues; and to try to avoid systemic crises generated by the temporary lack of liquidity that a credit institution may face. Members that want to remove the national discretion completely from the

CRD mention level playing field issues. Members who want to transform the national discretion into a general rule mention level playing field across EU and cross-border considerations; a common treatment across Member States/convergence; as well as market specificities and a lower risk of short term exposures.

4. **Impact on business**: 7 Members perceive an impact of this national discretion on level playing field issues. None or limited impact is mentioned by 7 Members and 1 respondent from the industry.

5. **Possible solution**: The negative aspects of this provision can be alleviated by allowing this favourable treatment - for short term exposures in its national currency to institutions - to all credit institutions. CEBS's proposal is to **delete the discretionary part of the provision**. The word 'may' in the Directive should replaced by 'shall' and the Member States that have not yet implemented this provision should be urged to do so. However some members argued that the preferred treatment of exposures which are denominated and funded in the same currency is risk adequate for exposures assigned to the exposure class 'central governments or central banks' (Annex VI part I points 4 and 5), but not for exposures assigned to the exposure class 'institutions which may not be able to pay their obligations'. Therefore the diminution of risk weights for long term obligations from 50%, 100% or 150% to at least 20% in the last three months may not be prudent.

6. **Drafting proposal:**

Exposures to institutions of a residual maturity of 3 months or less denominated and funded in the national currency shall be assigned, under both methods described in points 26 to 27 and 29 to 32, a risk weight that is one category less favourable than the preferential risk weight, as described in points 4 and 5, assigned to exposures to their central government.

29. Standardised approach, Annex VI, Part 1, Point 40 (Directive 2006/48/EC)

"Where an exposure to an institution is in the form of minimum reserves required by the ECB or by the central bank of a Member State to be held by a credit institution, Member States may permit the assignment of the risk weight that would be assigned to exposures to the central bank of the Member State in question provided: (…)"

Objective of the discretion: More permissive treatment of exposures in the form of minimum reserves required by the ECB or by the central bank if certain conditions are met.

1. **Overview of exercise:** Currently, 70% of the Member States exercise the discretion and 30% Member States do not exercise the discretion.

2. **Overview of responses**: 5 Members would like to keep the national discretion (of which 4 in its present form, 1 subject to mutual recognition) and

also 2 respondents from the industry (of which 2 in the present form). 22 Members would prefer to remove the national discretion (of which 20 respondents to transform it into a general rule and 2 Members favour removing the option from the CRD) and 5 respondents from industry would like to transform the national discretion into a general rule. Transformation into a general rule is mentioned by both Members and industry.

3. **Main drivers**: This national discretion is judged very important/important/fairly important by 14 Members and 3 respondents from the industry and indifferent/non relevant by 13 Members and 1 respondent from the industry. Members that want to keep the national discretion mention business specificities, that Member States should have the possibility of choosing between more/less strict regulations, and level playing field issues. Members that want to transform the national discretion into a general rule mention level playing field issues, common treatment across Member States/ convergence, market and business specificities, as well as better matching to the risk profile.

4. **Impact on business**: 6 Members perceive an impact from this national discretion on business. None or limited impact is mentioned by 8 Members and 1 respondent from the industry.

5. **Possible solution**: The negative aspects of this provision can be alleviated by allowing this favourable treatment to all credit institutions. The set of criteria that must be met before an institution could use this more permissive treatment appear adequate, which means that adherence to the criteria could and should be left to the institution that wants to make use of the more favourable treatment. (This can subsequently be challenged by the supervisor in the course of normal supervision.) For the sake of clarity the proposal is to **delete the discretionary part of this national discretion,** provided the conditions set are met.

6. **Drafting proposal:**

Exposures to an institution in the form of minimum reserves required by the ECB or by the central bank of a Member State to be held by a credit institution, shall be risk-weighted as exposures to the central bank of the Member State in question provided that the following conditions are met:

[…] and

[…] ".

30. Standardised approach, Annex VI, Part 1, Point 63 (Directive 2006/48/EC)

"Nonetheless, where a past due item is fully secured by forms of collateral other than those eligible for credit risk mitigation purposes, a 100 % risk weight may be assigned subject to the discretion of competent authorities based upon strict operational criteria to ensure the good quality of collateral when value adjustments reach 15% of the exposure gross of value adjustments."

Objective of the discretion: More permissive treatment of past due exposures under conditions.

1. **Overview of exercise:** Currently 17% of the Member States exercise the discretion (3% with a proviso) and 83% of the Member States do not exercise the discretion.

2. **Overview of responses**: 9 Members would prefer to keep the national discretion (of which 7 in its present form, 1 for supervisors to decide on a case by case basis, 1 subject to mutual recognition); and also 4 respondents from the industry (in the present form). 19 Members would prefer to remove the national discretion (of which 3 Members to transform it into a general rule, 16 Members to remove it from the CRD) as do 6 respondents from industry (of which 5 respondents to transform it into a general rule, and one in favour of removing the national discretion immediately from the CRD). Mutual recognition is mentioned by 3 Members, setting an expiry date by 2 Members, removing the option by 6 Members.

3. **Main drivers**: This national discretion is judged very important/important/fairly important by 18 Members and 5 respondents from the industry and indifferent/non relevant by 10 Members and 1 respondent from the industry. Members that want to keep the national discretion mention market and business specificities; legal situations; and aligning the provisioning policy to the risk management process. Respondents who want to remove the national discretion or transform it into a general rule mention level playing field issues across Member States; market conditions and cross-border aspects; as well as the preference for a common treatment across Member States; and the lack of the need for an additional threshold (preferring to use the threshold set in para. 61).

4. **Impact on business**: Half of the respondents perceive a high impact from this national discretion on business (for level playing field issues and existing market practices). The remaining half perceive no or limited impact.

5. **Possible solution**: This national discretion is currently applied in line with the market specificities and business practices of each country, but it hampers the level playing field and the risk of the exposures appears not to be fully in line with the more favourable treatment. **Deleting the provision** is preferable and possible. However it is important to allow a **transitional period of 10 years** in order to facilitate the countries with local market specificities gradually to change their market practices. A lengthy transition period is quite common for such cases (such as the proposal on hybrid capital instruments to be eligible as original own funds for 30 years or article 154 2006/48/EC which allows certain equity exposures to be exempted from the IRB treatment for a 10 year period).

6. **Drafting proposal:**

Nonetheless, until 31 December 2019, where a past due item is fully secured by forms of collateral other then those eligible for credit risk mitigation *purposes, a 100 % risk weight may be assigned subject to the discretion of competent authorities based upon strict operational criteria to ensure the good quality of the collateral when value adjustments reach 15 % of the exposure gross of value adjustments.*

31. Standardised approach, Annex VI Part 1 Point 64 (Directive 2006/48/EC)

"Exposures indicated in points 45 to 50 shall be assigned a risk weight of 100 % net of value adjustments if they are past due for more than 90 days. If value adjustments are no less than 20 % of the exposure gross of value adjustments, the risk weight to be assigned to the remainder of the exposure may be reduced to 50 % at the discretion of competent authorities."

Objective of the discretion: This national discretion allows a more permissive treatment for past due exposures secured by mortgages on residential property. They can get lower risk weighting if the conditions are met.

1. **Overview of exercise**: 67% of the Member States have exercised this national discretion and 33 % state that they have not.

2. **Overview of responses**: 13 Members want to keep the national discretion (11 in its present form, 2 in subject to mutual recognition). On the other hand 16 Members would like to remove this option (of which 13 would transform it into a general rule, 1 would remove it immediately from the CRD, 2 want to remove it after a transition period). 8 industry respondents (out of 11) want to transform it into a general rule. 3 industry respondents want to keep the national discretion in its present form. 17 Members and 3 industry respondents (out of 6) think that this national discretion is very important/important/fairly important. Mutual recognition and transforming it into a general rule are mentioned by several Members. 8 industry respondents would like to change the wording into a general rule.

3. **Main drivers**: Members who want to keep the national discretion in the present form mention: market specificities, to align the provisioning policy to risk management, consistency with the accounting rules, cross-border aspects, the possibility of choosing between more/less strict regulations. Members who want to transform it into a general rule mention: to encourage the firms to make allowances, high degree of convergence already exists, the specific conditions should be listed, and level playing field issues. The industry respondents who want transform it into a general rule mention that the national discretion leads to level playing field distortions and therefore it should be consistently applied when the preconditions are met.

4. **Impact on business**: 9 Members consider that it has impact. Some Members mention that it can create level playing field problems among institutions operating in the same market. 7 Members consider that there is no impact. Very few industry respondents have given any comments on the impact on business of this national discretion. 2 respondents consider that this national discretion has no impact on business.

5. **Possible solution**: Even though the view of the majority of respondents is to transform the national discretion into a general rule, the prudence of this discretion is questionable. According to the text, this provision could be perceived as a supervisory decision to be applied on a case by case basis that should have been implemented by all Member States (the provision says "at the discretion of the competent authorities" and not of the Member States). However, as the subject matter is mortgages on residential property, this is either a local market circumstance (for which binding mutual recognition is appropriate) or a provision which may no longer be appropriate from a risk perspective. The impact assessment and information available here are not sufficient. **Respondents are invited to provide additional input to support keeping the discretion (with added binding mutual recognition implicit in the criteria to be fulfilled)**. If no such input is received from respondents, CEBS will consider advice **to remove the provision** from the CRD with an appropriate **short transitional clause**. The final proposal should be consistent with the proposal on the discretion 33.

6. **Drafting proposal:** If the provision is ultimately kept, the following text is suggested to be adopted:

Exposures indicated in points 45 to 50 shall be assigned a risk weight of 100 % net of value adjustments if they are past due for more than 90 days. If value adjustments are no less than 20 % of the exposure gross of value adjustments, the risk weight to be assigned to the remainder of the exposure may be reduced to 50 % at the discretion of the competent authorities <u>of the Member State in which the residential property is located.</u>

If, on the other hand, CEBS decides to remove the provision from the CRD, then the provision would now read:

Exposures indicated in points 45 to 50 shall be assigned a risk weight of 100 % net of value adjustments if they are past due for more than 90 days.

7. **Other remarks:** Competent authorities should fully disclose the manner of their exercise of this national discretion in the supervisory disclosure framework, if they do not do so already.

32. Standardised approach, Annex VI Part 1 Point 66 (Directive 2006/48/EC)

"Subject to the discretion of competent authorities, exposures associated with particularly high risks such as investments in venture capital firms and private equity investments shall be assigned a risk weight of 150 %."

Objective of the discretion: The national discretion allows a more restrictive treatment for risk weighting of items belonging to regulatory high risk categories.

1. **Overview of exercise**: 70 % of Member States have exercised this national discretion (3% with a proviso). 27 % of the Member States state that they have not.

2. **Overview of responses**: 17 Members want to keep this national discretion (12 in its present form, 3 for supervisors to decide on a case by case basis, 2 subject to mutual recognition). On the other hand 11 Members would like to remove this national discretion (10 transform it into a general rule, 1 remove completely after a transition period from the CRD). 12 Members consider this national discretion very important or important. 7 industry respondents (out of 9) want to remove the national discretion immediately from the CRD. 2 respondents would like to keep it in its present form. One respondent wanting to keep this national discretion rates it important.

3. **Main drivers**: Members that want to keep the national discretion in the present form mention market specificities, and that the competent authority is in the best position to decide if a higher risk weight should be applied. Also it is mentioned that the Members should have the right to choose between more/less strict regulations. Members that want to transform it into a general rule mention level playing field issues, and that it is risk adequate to treat high risk exposures with a higher risk weight. Industry respondents who want to remove the national discretion immediately from the CRD mention that divergences in national application of this national discretion lead to level playing field problems. 12 Members responded that the best option would be to keep the national discretion in its present form and 10 Members wanted to transform it into a general rule while several Members have mentioned mutual recognition. Some suggested a list of assets commonly considered as highly risky. All industry respondents suggested that the national discretion should be removed completely.

4. **Impact on business**: 7 Members consider that this national discretion has no impact on business, 7 consider that the national discretion has some impact. Very few industry respondents have given any comments on the impact on business of this national discretion. 2 respondents consider that the national discretion has no impact on business.

5. **Possible solution**: The solution might be **to keep the discretion in the present form** to allow competent authorities the necessary flexibility they need to address "high risk" investments. Though this discretion is a supervisory decision (it says "subject to the discretion of competent authorities"), which can and should be applied on a flexible basis, it should and will indeed be applied across the board, to address the various high risk exposures which may come up in a developing market. As it is applied across the board it does qualify as a national discretion.

6. **Drafting proposal:** No change is necessary at the CRD level, but the provision should be implemented as a supervisory decision to be applied across the board at the national level.

7. **Other remarks**: To enhance the transparency of the application of this discretion, the criteria to assess "high risk" investments or even a list of such

investments could be included by each competent authority in the supervisory disclosure framework.

33. Standardised approach, Annex VI Part 1 Point 67 (Directive 2006/48/EC)

"Competent authorities may permit non past due items to be assigned a 150 % risk weight according to the provisions of this Part and for which value adjustments have been established to be assigned a risk weight of:

a) 100 %, if value adjustments are no less than 20 % of the exposure value gross of value adjustments; and

b) 50 %, if value adjustments are no less than 50 % of the exposure value gross of value adjustments"

Objective of the discretion: This national discretion allows a more permissive treatment for the regulatory high risk categories, which may get lower risk weights due to value adjustments.

1. **Overview of exercise**: 53% of the Member States have exercised this national discretion (6% with a proviso) and 40 % of Member States state that they have not.

2. **Overview of responses**: 8 Members want to keep this national discretion (6 in the present form, 2 as an option for credit institutions). On the other hand 18 Members would like to remove this national discretion (7 to transform it into a general rule, 3 to remove it completely from the CRD, 2 immediately and 6 after a transition period). For 13 Members keeping this option is fairly important and for 5 Members keeping it is very important or important. 3 industry respondents (out of 9) want to remove the national discretion immediately from the CRD, 3 industry respondents want to transform it into a general rule and 3 industry respondents would like to keep it in its present form. 2 (out of 5) industry respondents answered that keeping it is important. Mutual recognition is mentioned several times by Members, as well as removing the option and transforming it into a general rule. Respondents from the industry want to remove the option completely from the CRD or to transform it into a general rule.

3. **Main drivers:** Several Members who want to keep the national discretion in the present form mention market specificities and also that the competent authority should have the right to choose between more/less strict regulations. Members that want to remove the national discretion completely from the CRD (immediately or after a transition period) mention that the use of the option is difficult to justify. Both those industry respondents who want to transform the national discretion into a general rule and those who want to keep it in its present form justify their choice by referring to level playing field issues.

4. **Impact on business:** 9 Members consider that this option has an impact. The impact on cross-border groups is mentioned and also level playing field issues. 6 Members think that it has no impact. Very few industry respondents have given any comments on the impact on business of this national discretion. 2 industry respondents consider that the national discretion has no impact on business.

5. **Possible solution:** Though the national discretion is phrased like a supervisory decision, it can only be used across the board, and thus qualifies as a national discretion. The choice is therefore either to remove the national discretion if the more favourable treatment is not justified, or to grant it to all credit institutions by deleting the discretion from the provision. Unless in the **public consultation additional information is provided to justify the more favourable treatment, CEBS's tentative assessment is that the more favourable treatment is not justified**. The tentative **proposal is to remove the provision** from the CRD with an appropriate **short transitional clause**.

6. **Drafting proposal:**

<u>Until [31 December 2014]</u> competent authorities may permit non past due items to be assigned a 150 % risk weight according to the provisions of this Part and for which value adjustments have been established to be assigned a risk weight of:

a) 100 %, if value adjustments are no less than 20 % of the exposure value gross of value adjustments; and

b) 50 %, if value adjustments are no less than 50 % of the exposure value gross of value adjustments

34. Standardised approach, Annex VI Part 1 Point 68 (e) (Directive 2006/48/EC)

"(…) The competent authorities may recognise loans secured by commercial real estate as eligible where the Loan to Value ratio of 60 % is exceeded up to a maximum level of 70 % if the value of the total assets pledged as collateral for the covered bonds exceed the nominal amount outstanding on the covered bond by at least 10 %, and the bondholders' claim meets the legal certainty requirements set out in Annex VIII (...)"

Objective of the discretion: This national discretion allows a more permissive treatment for loans secured by commercial real estate as collateral for covered bonds.

1. **Overview of exercise**: 43 % of Member States have exercised this national discretion and 57 % state that they have not.

2. **Overview of responses:** 15 Members want to keep this national discretion (12 in the present form, 3 subject to mutual recognition). On the other hand

12 Members want to remove this option (4 to transform into a general rule, 8 to remove it completely from the CRD, of which 3 immediately and 3 after a transition period). 10 Members think that this national discretion is very important or important and 15 think it indifferent or not relevant. 5 industry respondents (out of 11) want to transform it into a general rule (3 remove it completely from the CRD, of which 2 immediately). Keeping it in its present form is the best option for 2 industry respondents. 3 (out of 6 industry respondents who reply to this question) think that this national discretion is very important or important. Several Members suggest mutual recognition and also removing the national discretion completely from the CRD. 6 respondents from industry suggest changing the wording to transform it into a general rule.

3. **Main drivers:** Members who want to keep the national discretion in the present form mention market conditions and cross border issues. Some Members consider that the assessment should be left to national competent authorities. Members who want to remove the national discretion completely from the CRD mention that the option is not very important as the majority of Member States do not exercise this option. Industry respondents who want to transform it into a general rule and also those who want to remove the option from the CRD mention level playing field issues.

4. **Impact on business:** 7 Members consider that this national discretion could have some impact and 8 Members that it has no impact on their business. Impact on level playing field issues is mentioned by some of them. Very few respondents from the industry have given any comment on the impact on business of this national discretion. 2 respondents consider that the national discretion has no impact on business.

5. **Possible solution:** The majority of Members do not exercise the option and are indifferent to this discretion. On the one hand, this provision allows for a less prudent treatment since it foresees the possibility of using a higher loan-to-value ratio. On the other hand, for some Members the option is very important as removing it (even with a long transitional period) would have a high impact on their economy. The level playing field considerations here are outweighed by the cost and impact in the Member States where it would be abolished. Due to the split interests, at the technical level the proposal therefore is **to keep this national discretion in the present form**.

6. **Drafting proposal**: No change necessary.

7. **Other remarks**: To expand on the reasons for this, using the example of one of the Member States for which it is very important. It argues that the domestic legal framework permits higher LTVs but ensures a similar level of prudence by requiring compulsory over-collateralisation and sound and prudent valuation criteria (sustainable value). Therefore these assets have specific characteristics which ensure the necessary quality to be included in the list of eligible assets to collateralize "covered bonds". In addition if this national discretion is eliminated, this fact would have a strong effect on their market for covered bonds, and a high impact on the banks issuing them. If a change is made, there would not be any covered bonds collateralised by loans secured by real estate because, following the domestic law, the whole real

estate portfolio collateralises the covered bond and it is not possible to segregate the portfolio depending on LTV levels . It is noted that though it is possible that the law could change in the future, this is not an issue to be determined by banking supervisors. Also, in this case it is important to point out that the current loans secured by commercial real estate used as collateral for covered bonds have a maturity of 20 years on average which should be taken account in such a non-technical decision.

35. Standardised approach, Annex VI Part 1 Point 85 (Directive 2006/48/EC)

"Member States may allow a risk weight of 10 % for exposures to institutions specialising in the inter-bank and public-debt markets in their home Member States and subject to close supervision by the competent authorities where those asset items are fully and completely secured, to the satisfaction of the competent authorities of the home Member States, by a items assigned a 0 % or a 20 % risk weight and recognised by the latter as constituting adequate collateral."

Objective of the discretion: This national discretion allows a more permissive treatment for risk weighting of institutions specialising in the inter-bank and public debt markets.

1. **Overview of exercise**: 27 % of the Member States have exercised this national discretion and 70 % state that they have not, 3% of Member States has not yet finally decided.

2. **Overview of responses**: 6 Members want to keep this national discretion (5 in the present form, 1 subject to mutual recognition). On the other hand 15 Members want to remove this option (12 removing it completely from the CRD of which 5 immediately and 5 after a transition period, 3 to transform it into a general rule). 9 Members have no preference. One Member considered the national discretion important initially. The majority (21 out of 27) of Members consider it indifferent or not relevant. 7 industry respondents (out of 9) want to remove this national discretion completely from the CRD, 6 of which would prefer to remove it immediately. 1 respondent has no preference. Members propose mutual recognition, or setting an expiry date for deleting this option. All industry respondents who answered on this point suggest that the option should be removed completely from the CRD.

3. **Main drivers:** Members who want to remove this option from the CRD mention that the option is not relevant. The majority of the Member States do not exercise this option and it would cause market distortion to exercise it. Members who would like to keep the option in the present form mention that Member States should have the possibility of choosing between more or less strict regulations. Industry respondents who want to remove the option completely from the CRD mention that divergences in national application of this rule lead to level playing field distortions.

4. **Impact on business:** 3 Members perceive that this national discretion could have some impact on their business whereas the majority consider that there is no impact. Only 1 industry respondent has commented on this point and it considers that this national discretion has no impact on business.

5. **Possible solution**: Upon further analysis, the national discretion was not considered to be important by any of the Members. As in this case the benefits of removing it in line with industry proposals outweigh any use being made of the national discretion, there is no obstacle to removing the national discretion from the CRD. The proposal is to **delete the provision** from the CRD.

6. **Drafting proposal**: Delete Annex VI Part 1 Point 85 of Directive 2006/48/EC.

36. Standardised approach, VI Part 3 Point 17 (Directive 2006/48/EC)

"Notwithstanding point 16, when an exposure arises through a credit institution's participation in a loan that has been extended by a Multilateral Development Bank whose preferred creditor status is recognised in the market, competent authorities may allow the credit assessment on the obligors' domestic currency item to be used for risk weighting purposes."

Objective of the discretion: This national discretion allows a more permissive treatment. It allows exceptions to the non-use of domestic currency ratings for foreign currency exposures.

1. **Overview of exercise**: 77 % of the Member States have exercised this national discretion and 23 % state that they have not.

2. **Overview of responses:** 12 Members want to keep this national discretion (9 in the present form, 1 to decide on a case by case basis, 1 subject to mutual recognition, 1 as an option for credit institutions). On the other hand 13 Members want to remove this option (10 to transform it to a general rule, 3 to remove it completely from the CRD). 5 Members have no preference. 15 Members consider this national discretion as indifferent or not relevant and 6 Members think it is fairly important. 5 (out of 9) industry respondents want to transform it into a general rule (1 keep the national discretion in the present form; 1 to remove the national discretion immediately from the CRD). Two respondents have no preference. Mutual recognition, transforming it into a general rule, and removing it completely from the CRD are mentioned as solutions by Members. 3 respondents from the industry want to change the wording to transform it into an option for credit institutions and 3 others into a general rule.

3. **Main drivers**: Members who want to keep the national discretion in the present form mention level playing field issues and that this approach is appropriate due to the low risk associated with such lending. They also mention that the decision should be left to the discretion of the supervisory authorities. Members who want to transform it into a general rule mention the advantages of a uniform treatment and a level playing field across the EU. It

is also mentioned that this national discretion is a very specific option (limited scope) which has limited impact on the total capital requirement. Industry respondents who want to transform it into a general rule mention that divergence across EU supervisors would not be justified and would lead to level playing field distortions.

4. **Impact on business**: 7 Members consider that this national discretion could have some impact. 9 Members perceive no impact or minor impact. Impact on cross-border issues is mentioned. Only one industry respondent replied and perceives no impact.

5. **Possible solution**: The provision has limited impact, but positively impacts on the approach to multilateral development banks (MDBs). The proposal is to **delete the discretionary part of the provision** as this seems both prudent and the most efficient solution.

6. **Drafting proposal:**

Notwithstanding point 16, when an exposure arises through a credit institution's participation in a loan that has been extended by a Multilateral Development Bank whose preferred creditor status is recognised in the market, the credit assessment on the obligors' domestic currency item <u>*shall*</u> *be used for risk weighting purposes.*

Area: IRB

37. IRB, Article 84.2. (Directive 2006/48/EC)
"Where an EU parent credit institution and its subsidiaries or an EU parent financial holding company and its subsidiaries use the IRB Approach on a unified basis, the competent authorities may allow minimum requirements of Annex VII, Part 4 to be met by the parent and its subsidiaries considered together."
Objective of the discretion: The objective is to consider the group as a whole, without a substantial distinction between parent and subsidiary levels, as regards the IRB requirements. It goes in the direction of a less restrictive approach.

1. **Overview of exercise**: 83% of Member States exercise this discretion (13% with a proviso); 17% do not exercise it.

2. **Overview of responses:** Among Members, 11 have opted for the option for supervisors to decide on a case by case basis, 8 for transforming it into a general rule and 7 are in favour of keeping it in its present form. Only a few responses have been submitted by industry on this discretion. Four industry respondents opted for transforming it into a general rule.

3. **Main drivers:** As regards the main drivers of the choices, it seems that the prevalent view is that the decision by the supervisor to allow the minimum requirements to qualify for the IRB to be met by parent and subsidiaries

taken together is part of the approval process for IRB qualification since it closely reflects the structure of the specific banking group and the way this is organised as regards risk management processes and methodologies. Therefore, this national discretion has to be decided on a case by case basis.

4. **Impact on business:** A low to medium impact on business is expected, though the national discretion is perceived to be quite important.

5. **Possible solution:** This option belongs to supervisors on a case by case basis in the context of the **supervisory approval process**. In fact in CEBS's opinion this provision **is not intended to be a national discretion, but a supervisory decision** to be applied on a case by case basis that should have been implemented by all Member States. It should also be applied as such. The text of the Directive should be kept unchanged and the Member States that have not yet implemented this provision as a supervisory decision to be used on a case by case basis should be urged to do so as soon as possible.

6. **Drafting proposal:** No change necessary at the CRD level, but the provision should be implemented as a supervisory decision at the national level.

38. IRB, Annex VII, Part. 1, Point 6 (Directive 2006/48/EC)

"The Competent Authorities may authorise a credit institution generally to assign preferential risk weights of 50% to exposures in category 1, and a 70% risk weight to exposures in category 2, provided the credit institution's underwriting characteristics and other risk characteristics are substantially strong for the relevant category."

Objective of the discretion: Subject to certain conditions, it allows more favourable risk weights for SL exposures.

1. **Overview of exercise:** 73% of Member States have exercised this national discretion (7% with a proviso); 27% have not exercised it.

2. **Overview of responses:** 7 Members opted for keeping it in the present form, and 4 Members for supervisors to decide on a case by case basis. As regards the preferences for removing it, 7 Members opted for transforming it into a general rule while 5 Members prefer to remove the national discretion from the CRD. As regards the industry response, some chose to make it an option for credit institutions while others for transforming the national discretion into a general rule.

3. **Main drivers:** The idea is that in the presence of strong requirements, lower capital requirements can be associated with SL exposures. However, given the current formulation of the CRD text ("*provided the credit institution's underwriting characteristics and other risk characteristics are substantially strong for the relevant category*") the interpretation of the conditions can vary.

4. **Impact on business:** According to the ranking, it does not seem a high priority issue; however, its impact on project finance business is likely to be rather important as regards a level playing field given the international nature of the business and of its players. A particular issue is the level playing field with the USA. A change from the text set out in the Basel II proposals on this issue would have a high impact on markets and the level playing field, and so should be considered only at a worldwide level.

5. **Possible solution:** Given that the majority of Member States have implemented this national discretion in their national rules, a possible solution would be to transform it into a option for institutions (obviously, the supervisory assessment will be part of the more general IRB approval process). However, in order to ensure a level playing field, **respondents are invited to provide CEBS with information on the criteria used in practice to assign the preferential risk weights.** In the meantime, the proposal is to **implement the provision as a supervisory decision which is part of the approval process**. As such, it should be applied on a case by case basis and should have been implemented as such by all Member States (the provision says "Competent authorities may authorise" and not the Member States). The text of the Directive should be kept unchanged and the Member States that have not implemented this provision should be urged to do so.

6. **Drafting proposal:** No change is necessary at this stage at the CRD level, but the provision should be implemented as a supervisory decision at the national level within the scope of the approval process.

39. IRB, Annex VII, Part. 1, Point 13 (last sentence) (Directive 2006/48/EC)

"By way of derogation from point (b), competent authorities may waive the requirement that the exposure be unsecured in respect of collateralised credit facilities linked to a wage account."

Objective of the discretion: The discretion is rooted in local market specificities and reflects a common practice in several Member States.

1. **Overview of exercise:** 70% of Member States have exercised this national discretion.

2. **Overview of responses:** 8 Members have no preference on this national discretion. Among the others, the majority of Members opted for transforming it into a general rule. Among the industry respondents, some expressed their preference for the option to be left to the banks themselves; others opted for the transformation of the national discretion into a general rule.

3. **Main drivers:** The main focus seems to be local market conditions and/or market practices; however, a different treatment across EU countries could jeopardize level playing field conditions in the retail markets. According to

the ranking, it is not a high priority issue; rather it seems to be an issue relevant only for some countries.

4. **Impact on business:** It is seen by respondents as not being particularly significant.

5. **Possible solution:** According to the CRD text, this provision should be a supervisory decision to be applied on a case by case basis that should have been implemented by all Member States (the provision says "the competent authorities may waive" and not the Member States). However, in practice, where exercised this discretion can only be applied across the board which means that in substance it is a national discretion. As the subject matter is collateral linked to wage accounts this discretion relates to local market conditions for which binding mutual recognition is appropriate. Additionally the discretion relates to national laws other than banking laws and reflects a common practice in several Member States. As a result, the proposal is to **keep the national discretion with added binding mutual recognition**.

6. **Drafting proposal:** Add to the CRD provision a binding mutual recognition clause:

> *(…) When by way of derogation from point (b) the requirement is waived by the competent authorities of the Member State where the wage account is located, the competent authorities of another Member State shall also allow institutions to disregard the requirement in respect of those wage accounts.*

40. IRB, Annex VII, Part 1, Point 18 (Directive 2006/48/EC)

"Notwithstanding point 17, competent authorities may allow the attribution of risk weighted exposure amounts for equity exposures to ancillary services undertakings according to the treatment of other non credit- obligation assets."

Objective of the discretion: Given the IRB treatment of equity exposures, the capital effect of this rule would certainly be to reduce the capital requirements (vis à vis a 100% RW).

1. **Overview of exercise:** 87% of Member States have exercised this national discretion.

2. **Overview of responses:** There is a broad consensus on this national discretion both among supervisors and market participants: the preferred option is to transform it into a general rule.

3. **Main drivers:** Two main drivers are identified by respondents: the risk profile of these exposures as well as level playing field issues.

4. **Impact on business**: This national discretion is ranked as fairly important.

5. **Possible solution:** The provision is not intended to be a national discretion, but a supervisory decision to be applied on a case by case basis that should have been implemented by all Member States. It should also be applied as

such and the Member States that have not yet implemented this provision as a supervisory decision to be used on a case by case basis should be urged to do so as soon as possible. However, since this rule goes in the direction of avoiding an excessive burden for banks, given that the assignment of an internal rating to such exposures would be neither feasible nor economically meaningful, the proposal is to **delete the discretionary part of the provision.**

6. **Drafting proposal**:

Notwithstanding point 17, risk weighted exposure amounts for equity exposures to ancillary services undertakings <u>shall</u> be treated according to the treatment of other non credit-obligation assets.

41. IRB, Annex VII, Part. 2, Point 5 and 7 & Annex VIII, Part 1, Point 26 (Directive 2006/48/EC)

Point 5, second sentence: "(…) For dilution risk, however, competent authorities may recognise as eligible unfunded credit protection providers other than those indicated in Annex VIII, Part 1."

Point 7, fourth sentence: "(…) Competent authorities may recognise as eligible unfunded credit protection providers other than those indicated in Annex VIII, Part 1. (…)"

Point 26: "The following parties may be recognised as eligible providers of unfunded credit protection: (…)"

Objective of the discretion: More favourable treatment.

1. **Overview of exercise:** Only 43% of Member States have exercised this national discretion.

2. **Overview of responses:** As regards supervisory preferences, 13 Members opted for keeping it in its present form and 11 Members opted for removing it immediately from the CRD. On the industry side the picture is also quite heterogeneous: some would prefer transformation into a general rule, others opted for the application of the mutual recognition clause, others for removing it immediately from the CRD text.

3. **Main drivers:** Local market conditions and market practices. According to the ranking, it is a medium-low priority issue.

4. **Impact on business**: Not fully clear at the moment since the input received is not clear.

5. **Possible solution:** The **tentative proposal is to remove the provisions** from the CRD **unless further input from respondents on the costs and benefits of removing the provision shows otherwise**. This leaves the option of choosing eligible providers of unfunded credit protection to the credit institution from the list contained in para 26 of annex VIII. If other

providers are deemed eligible, they can be added to this technical list in Annex VIII via the comitology process, giving the benefits to all credit institutions across the EU.

6. **Drafting proposal:** Deletion of Annex VII, Part. 2, Point 5, second sentence, and Annex VII, Part. 2, Point 7, fourth sentence.

42. IRB, Annex VII, Part. 2, Point 12 and 13 (Directive 2006/48/EC)
Point 12, last sentence: "(…) Competent Authorities may require all credit institutions in their jurisdiction to use maturity (M) for each exposure as set out under point 13." (i.e. in accordance with formulae instead of using values by default (0.5 years for repos and 2.5 for other exposures).
Objective of the discretion: It goes in the direction of a more risk-sensitive (and more burdensome) measurement of M in the FIRB approach.

1. **Overview of exercise:** Only 36% of Member States have implemented this national discretion.

2. **Overview of responses:** 12 Members opted for removing this national discretion from the CRD text; 9 Members opted for keeping it in the present form. The few industry respondents on the issue are equally split between removing it from the CRD and leaving it as an option for institutions.

3. **Main drivers:** The main drivers are local market conditions and market practices. According to the ranking, it is a medium priority issue, even though for some countries where banks have already opted for this discretion the issue is more relevant.

4. **Impact on business**: Some respondents perceive some degree of impact.

5. **Possible solution:** There is a variety of different approaches among Members and it was not possible at this stage to reach a consensus on this national discretion. On one hand it does not seem sensible to delete the provision since it goes in the direction of a more risk-sensitive approach; on the other hand it seems difficult to delete the discretion and make the provision a general rule since only a minority of Member States have implemented it and seem to be applying it in a proportionate way. The proposal is thus to **keep the national discretion as it is.**

6. **Drafting proposal:** No change necessary.

43. IRB, Annex VII, Part. 2, Point 15, first sentence (Directive 2006/48/EC)
"The competent authorities may allow for exposures to corporates situated in the Community and having consolidated sales and consolidated assets of less than EUR 500 million the use of M as set out in point 12. (…)"

Objective of the discretion: Allows a less risk sensitive approach.

1. **Overview of exercise:** Only 30% of Member States have exercised this national discretion.

2. **Overview of responses:** 17 Members opted for removing this national discretion from the CRD text. 9 Members opted for keeping it in its present form. The few industry respondents on the issue are equally split between removing it from the CRD and leaving it as an option for institutions.

3. **Main drivers:** Are local market conditions and market practices. According to the ranking, it is a medium priority issue.

4. **Impact on business:** Some respondents perceive some degree of impact

5. **Possible solution:** Given that this discretion entails a less sensitive approach, that has medium-low importance and that only a few authorities have implemented it, it is proposed **to remove the provision from the CRD with a transitional period of 10 years and grandfathering clauses.** CEBS is, however, open to the argument that even this transitional approach combined with grandfathering may have too great an impact on the markets in two Member States, and especially on the funding possibilities for SMEs in those Member States. **Respondents to the public consultation are invited to put forward their opinions and substantiating evidence on this.** If this sways the cost/benefit analysis in the direction of keeping it to even the level playing field either a binding or a non-binding mutual recognition clause for business done in the two Member States could also be added (if kept or during any transitional period).

6. **Drafting proposal:**

<u>[Until 31 December 2019,]</u> the competent authorities <u>of a Member State</u> may allow for exposures of an institution to corporates <u>situated in the Member State</u> and having consolidated sales and consolidated assets of less than EUR 500 million the use of M as set out in point 12. <u>After the expiry of this clause, commitments already given for such exposures may continue to be treated in this way to the extent drawn before this date</u>

7. **Other remarks:** Depending on input from respondents, it will either be deleted in the long term, or substantiating evidence will be included in the final advice showing that deleting this exception will have a too high an impact on the markets in at least two Member States, in particular on SME financing in those markets. For this reason, level playing field considerations and the preference for a risk-based approach could in that case be outweighed by the impact on the local market(s).

44. IRB, Annex VII, Part. 2, Point 15, last sentence (Directive 2006/48/EC)

" (…) Competent authorities may replace EUR 500 million total assets with EUR 1000 million total assets for corporates which primarily invest in real estate."

Objective of the discretion: same as previous national discretion.

1. **Overview of exercise:** Only 17% of Member States have exercised this national discretion.

2. **Overview of responses:** Most supervisory authorities opted for removing this national discretion from the CRD text, although some others opted for keeping it in its present form. The few industry respondents on the issue are equally split between removing it from the CRD and leaving it as an option for institutions.

3. **Main drivers:** Are local market conditions and market practices. According to the ranking, it is a medium priority issue.

4. **Impact on business:** Respondents perceive the impact of the divergent exercise of this discretion as being low.

5. **Possible solution:** Given that this discretion entails a less sensitive approach, that has medium-low importance and that only a few authorities have implemented it, the proposal is **to remove the provision from the CRD with a long transitional period of 10 years and grandfathering clauses.** CEBS is, however, open to the argument put forward that even this transitional approach combined with grandfathering may have too great an impact on the markets in two Member States, and especially on the funding possibilities for SMEs in those Member States. **Respondents to the public consultation are invited to put forward their opinions and substantiating evidence on this.** If this sways the cost/benefit analysis into the direction of keeping it, to even the level playing field either a binding or a non-binding mutual recognition clause for business done in the two Member States could also be added (or if the provision is removed mutual recognition might still be useful during any transitional period)..

6. **Drafting proposal:**

<u>Until 31 December 2019, competent</u> authorities of a Member State may replace EUR 500 million total assets with EUR 1000 million total assets for corporates in the Member State which primarily invest in real estate. <u>After the expiry of this clause, commitments already given for such exposures may continue to be treated in this way to the extent drawn before this date.</u>

7. **Other remarks:** Depending on input from the industry and other interested parties, it will either be deleted in the long term, or substantiating evidence will be included in the final advice to show that deleting this exception will have too high an impact on the markets in at least two Member States, in particular on SME financing in those markets. For this reason, level playing field considerations and the preference for a risk-based approach would in that case be outweighed by the impact on the market.

45. IRB, Annex VII, Part. 2, Point 20 & Annex VIII Part 1, Point 26 (Directive 2006/48/EC)

Point 20: "Unfunded credit protection may be recognised as eligible by adjusting PDs subject to point 22. For dilution risk, where credit institutions do not use own estimates of LGD, this shall be subject to compliance with articles 90 to 93; for this purpose, competent authorities may recognise as eligible unfunded protection providers other than those indicated in Annex VIII, Part 1."

Objective of the discretion: The objective of the discretion, when applied, is to recognise other providers for dilution risk. This discretion, when applied, will reduce capital requirements. It goes in the direction of a more permissive approach.

1. **Overview of exercise**: 40% of Member States have applied this discretion and 60% have not applied it.

2. **Overview of responses:** 15 Members consider this national discretion should be kept in the present form, 1 Members thinks it should be left to supervisors to decide on a case by case basis and 2 Members have chosen mutual recognition as the best option. On the other hand, 10 Members consider that it should be removed from the Directive; six of them immediately and 2 of them after a transition period. 2 industry respondents consider that it should be kept in its present form because of local business specificities and 4 industry respondents think that it should be kept in its present form but subject to mutual recognition to avoid level playing field distortions (for this purpose 1 industry respondent proposes that CEBS works on the convergent application of this provision and maintains a list). Finally, 2 industry respondents believe that this national discretion should be removed immediately because it leads to fragmentation of the EU and to competitive distortions.

3. **Main drivers:** Main reasons to keep the national discretion are related to market and business specificities. Main reasons to delete the provision from the CRD are that protection providers for dilution risk should meet the same eligibility criteria as for default risk and that it can create level playing field problems among institutions operating in the same market.

4. **Impact on business:** Generally speaking Members and industry do not expect a material impact on their business.

5. **Possible solution:** This national discretion was analysed in conjunction with national discretion number 41. The tentative proposal is to **delete the provision from the CRD unless further input from respondents on the costs and benefits of removing the provision shows otherwise**. This leaves the option of choosing eligible providers of unfunded credit protection to the credit institution from the list contained in para 26 of annex VIII. If other providers are deemed eligible they can be added to this technical list in Annex VIII via the comitology process giving the benefits to all credit institutions across the EU.

6. **Drafting proposal:** Deletion of Annex VII, Part. 2, Point 20, last part of the second sentence of Directive 2006/48/EC ("for this purpose competent authorities…")

46. IRB, Annex VII, Part. 4, Point 56 (Directive 2006/48/EC)

"If credit institutions can demonstrate to their competent authorities that for data that have been collected prior to the date of implementation of this Directive appropriate adjustments have been made to achieve broad equivalence with the definition of default or loss, competent authorities may allow the credit institutions some flexibility in the application of the required standards for data."

Objective of the discretion: The objective of the discretion, when applied, is to allow institutions to use past data (i.e. collected prior to the implementation date of Basel II) which do not fully comply with the requirements set out in the Directive, i.e. helping institutions to implement IRB approaches.

1. **Overview of exercise:** 83% of the Member States are exercising this discretion with a further 10% exercising it with a proviso and 7% do not apply it.

2. **Overview of responses:** 7 Members consider that this national discretion should be kept in its present form and 7 Members think it should be left to supervisors to decide on a case by case basis. On the other hand, 1 Member proposes to remove it immediately because this option is only important for the initial implementation of the CRD and 4 Members think it should be removed after a transition period. The majority (11) think that the best solution is to transform it into a general rule (i.e. the obligation to make some adjustments is sufficient to avoid miscalibration, it is necessary to allow it in order to have a data history as long as possible). 7 industry respondents consider that the best option is to transform it into a general rule. 2 industry respondents consider it should be kept in its present form because of business specificities and because without this option it would be impossible for many institutions to start using the internal rating approach.

3. **Main drivers:** Main reasons to keep the national discretion are market and business specificities and conditions of the institutions.

4. **Impact on business:** Most Members do not expect material impacts on their business; furthermore, as time goes by and banks collect more recent data for their time series, the relevance of data collected prior to implementation date is expected to decrease.

5. **Possible solution:** Given that the large majority of Member States have adopted this discretion it is proposed to retain this discretion, as is, until 2014. This timescale is consistent with the data requirements framework to calculate PDs and LGDs. In fact this provision **is not intended to be a national discretion, but a supervisory decision** (the provision says "competent authorities may allow" and not the Member States) to be applied

on a case by case basis (i.e. within the IRB approval process) that should have been implemented by all Member States. It should also be applied as such. The text from the Directive should be kept unchanged and the Member States that have not yet implemented this provision as a supervisory decision to be used on a case by case basis should be urged to do so as soon as possible.

6. **Drafting proposal:** No change necessary at the CRD level, but the provision should be implemented as a supervisory decision at the national level.

Area: CRM

47. CRM, Annex VIII, Part 1, Point 15 (Directive 2006/48/EC)

"The competent authorities may also authorise their credit institutions to recognise as eligible collateral shares in Finnish housing companies operating in accordance with the Finnish Housing Company Act of 1991 or subsequent equivalent legislation as commercial real estate collateral, provided that these conditions are met"

Objective of the discretion: The objective of this national discretion is to recognise a particular market.

1. **Overview of exercise**: 40% of Member States have applied this discretion, 57% have not and 3% have not yet decided.

2. **Overview of responses:** This national discretion is mainly relevant for Finland given the nature of the Finnish residential real estate market. 4 Members consider this national discretion should be kept in its present form, 1 Member thinks that it should be kept subject to mutual recognition and 1 proposes to keep it as an option for credit institutions. However, 5 Members want to remove it immediately or after a transitional period and 6 Members think that the best option is to transform it into a general rule to ensure a level playing field. Finally 12 Members have no preference. 1 industry respondent considers it should be kept in its present form because of business specificities, 1 industry respondent considers it should be removed immediately and 5 industry respondents propose to transform it into a general rule. 2 Members classify this national discretion as very important1 as important, 4 Members and 1 industry respondent as fairly important, 6 Members as indifferent and 14 Members and 3 industry respondents say it is not relevant for the respondent.

3. **Main drivers:** Although there is variety of views, respondents wanting to keep the national discretion in the current form indicate market and business conditions and practices as a main driver. Respondents that want to transform it into a general rule give as reasoning ensuring level playing field.

4. **Impact on business:** Generally speaking Members and industry do not expect material impacts on their business.

5. **Possible solution**: The national discretion has a low impact, but it used in one Member State extensively and has a clear benefit there. The costs of maintaining the provision could be reduced by levelling the playing field. If kept, it should be available to all credit institutions doing business with these clients at their own discretion. This would not raise significant prudential concerns. It is therefore proposed to transform it into an **option for credit institutions**. Although equivalent structures exist in other Member States these are considered to be out of the scope of CEBS's work to analyse these cases.

6. **Drafting proposal:**

Credit institutions may use as eligible collateral shares in Finnish housing companies operating in accordance with the Finnish Housing Company Act of 1991 or subsequent equivalent legislation as commercial real estate collateral, provided that these conditions are met.

7. **Other remarks**: To expand on the reasons behind the proposals: housing companies are a typical housing system in Finland; the shares in a housing company give their owner the right of possession of a specific apartment. The shares are treated as personal property and can be sold and used as collateral for a loan. The owners pay a monthly fee to the housing company to cover maintenance costs, heating costs and the water supply. The maintenance charge can also be used for renovations and modernizations aimed at making the real estate and building meet current requirements. Housing companies' policies are defined by owners in shareholders meetings. The board of the housing company is elected at the shareholders meeting. The board sees to the management of the housing company. From the collateral point of view the shares are regarded as good collateral because housing in Finland is generally new or recent and of a good quality. The housing company is normally keeping the building, real estate and apartments in good shape. The housing market in Finland is effective and functional. The shares are considered to be as good collateral as residential real estate. Even in the recession years Finnish banks experienced very rare losses from housing loans, partly due to the good quality of the collateral.

48. CRM, Annex VIII, Part 1, Point 20 (Directive 2006/48/EC)

"The competent authorities may recognise as eligible collateral amounts receivable linked to a commercial transaction or transactions with an original maturity of less than or equal to one year. Eligible receivables do not include those associated with securitisations, sub-participations or credit derivatives or amounts owed by affiliated parties."

Objective of the discretion: This national discretion allows a more permissive treatment recognising a wider number of collateral.

1. **Overview of exercise:** 90% of the Member States are exercising this discretion with a further 3% exercising it with a proviso and 7% do not apply it.

2. **Overview of responses:** 9 Members consider this national discretion should be kept in its present form; 1 thinks that supervisors should decide on a case by case basis and 1 Member proposes to keep it as an option for credit institutions. On the other hand, 19 Members consider the best option is to transform it into a general rule. 2 industry respondents consider it should be kept in its present form and 7 industry respondents propose to transform it into a general rule. 1 Member State and one industry respondent classify this national discretion as very important, 8 Members and 1 industry respondent as important, 13 Members and 1 industry respondent as fairly important, 6 Members as indifferent and 1 industry respondent as not relevant for the respondent .

3. **Main drivers**: Main drivers to keep the national discretion in its current form or as an option for credit institutions are local market and business specificities and one Member also indicates this treatment adds to the risk sensitivity of the proposals. Main drivers to transform the national discretion into a general rule are uniform treatment, level playing field, cross border considerations, common market sense, very high degree of convergence already existing

4. **Impact on business**: Generally speaking, Members and industry do not expect material impacts on their business but some point out that it can create level playing field problems.

5. **Possible solution**: This provision is not intended to be a national discretion, but a supervisory decision (the provision says "competent authorities may recognise" and not the Member States) to be applied on a case by case basis that should have been implemented by all Member States. It should also be applied as such. In principle the text from the Directive could be kept unchanged and the Member States that have not yet implemented this provision as a discretion to be used on a case by case basis should be urged to do so as soon as possible. However this seems to be an area where convergence could be possible through the **deletion of the discretionary part of the provision.** It is noted however, that due to specific market conditions and legal environment one Member considers receivables as very poor collateral and very sensitive to economic cycle and not suitable to be recognized as eligible collateral.

6. **Drafting proposal:**

Collateral amounts receivable linked to a commercial transaction or transactions with an original maturity of less than or equal to one year <u>will be recognised</u> as eligible collateral. Eligible receivables do not include those associated with securitisations, sub-participations or credit derivatives or amounts owed by affiliated parties.

49. CRM, Annex VIII, Part 1, Point 21 (Directive 2006/48/EC)

"The competent authorities may recognise as eligible collateral physical items of a type other than those types indicated in points 13 to 19 if satisfied as to the following: (a) liquid markets for disposal of the collateral do exist in an expeditious and economically efficient manner; and (b) well-established, publicly available market prices for the collateral do exist. The institution must be able to demonstrate that there is no evidence that the net prices it receives when collateral is realised deviates significantly from these market prices.”

Objective of the discretion: The Competent Authorities may recognise as eligible collateral physical items of a type other than real estate collateral. This national discretion allows a more permissive treatment recognising a wider range of collateral.

1. **Overview of exercise:** 77% of the Member States are exercising this discretion with a further 7% exercising it with a proviso and 16% do not apply it.

2. **Overview of responses:** Although 14 Members have chosen the option to keep it in the present form, most of them add as a possible solution keeping it subject to mutual recognition. 2 Members think that supervisor should decide on a case by case basis, 3 Members explicitly say that it should be subject to mutual recognition and 2 Members propose to keep it as an option for credit institutions. On the other hand, 9 Members consider the best option is to transform it into a general rule. 2 industry respondents consider it should be kept in its present form because of business specificities and 8 industry respondents propose to transform it into a general rule to avoid level playing distortions. 3 Members and 2 industry respondents classify this national discretion as “very important”, 8 Members as “important”, 13 Members and 2 industry respondents as “fairly important”, 3 Members as “indifferent” and 1 Member State and 1 industry respondent as “not relevant for the respondent”.

3. **Main drivers**: Main driver behind Members that want to keep the national discretion are local market and business specificities. Main drivers behind the input of the other Members are market specificities, the high degree of convergence already existing and avoiding level playing field problems. The industry refers to the level playing field.

4. **Impact on business**: At least 7 Members expect some or significant impact on their business and for some of them it can create level playing field problems.

5. **Possible solution**: The analysis shows that the provision is quite important in a few Member States. There would be a high impact from deleting the provision, while on the other hand it is not relevant elsewhere, and it would be less prudent to introduce it across the board. The cost of keeping the national discretion can be adequately compensated by adding mutual recognition. The proposed solution is therefore **to keep the national discretion as it is** but add a **non-binding mutual recognition clause**. Where the collateral is local, and recognized due to local market conditions, other supervisors will be expected to take on board the local supervisors’ judgement. As this article can also apply to collateral which is not bound to the local market, but also to collateral in other Member States and in third countries, binding mutual recognition cannot be proposed here.

6. **Drafting proposal**:

The Competent Authorities may recognise as eligible collateral physical items of a *type other than* those types indicated in points 13 to 19*, if satisfied as to the following: (a) liquid markets for disposal of the collateral in an expeditious and economically efficient manner do exist; and (b) well-established, publicly available market prices for the collateral do exist. The institution must be able to demonstrate that there is no evidence that the net prices it receives when collateral is realised deviates significantly from these market prices. Either the criteria used or the list of physical items recognised as eligible collateral other than real estate shall be disclosed by each competent authority in the supervisory disclosure framework referred to in Article 144 of this Directive.*

When this discretion is exercised by the competent authorities of one Member State for a type of collateral, the competent authorities of another Member States may allow their credit institutions to recognise that collateral as eligible.

50. CRM, Annex VIII, Part 1, Point 28 (Directive 2006/48/EC)

"By way of derogation from point 26, the Member States may also recognise as eligible providers of unfunded credit protection, other financial institutions authorised and supervised by the competent authorities responsible for the authorisation and supervision of credit institutions and subject to prudential requirements equivalent to those applied to credit institutions."

Objective of the discretion: It goes in the direction of a less restrictive approach.

1. **Overview of exercise:** 43% of Member States have applied this discretion, 53% have not and 3% have not yet decided.

2. **Overview of responses:** 9 Members prefer to keep this national discretion in its present form. 1 Member considers that the supervisor should decide on a case by case basis and 6 have chosen as the best option keeping it subject to mutual recognition. On the contrary, 4 Members consider that this national discretion should be removed immediately or after a transition period. Finally 7 Members propose transforming this national discretion into a general rule. 2 industry respondents consider it should be kept in its present form and 8 industry respondents propose transforming it into a general rule. 3 Members and two industry respondents classify this national discretion as "very important", five Members as "important", 14 Members and 2 industry respondents as "fairly important", five Members as "indifferent" and one country and one industry respondent as "not relevant for the respondent".

3. **Main drivers:** Main reasons to keep the national discretion in its current form are local market and business specificities, national regulation related aspects or the opportunity to consider contagion risk. Members wanting to delete the provision from the CRD say this treatment is neither needed nor

risk sensitive. Industry respondents that want to transform it into a general rule have as a main reason avoiding level playing field distortions

4. **Impact on business:** Some Members expect a significant/moderate impact on their business and for some of them it can create level playing field problems.

5. **Possible solution**: As in national discretions 41 and 45, additional eligible providers of unfunded credit protection can be added to the list in paragraph 26. However, those national discretions cover additional unidentified categories of eligible providers, while here the conditions are clear but require a local assessment of equivalence and supervision. If other institutions are equivalently supervised as credit institutions, there is no reason not to allow this, but their protection should be available to all credit institutions to prevent level playing field costs. The proposal is **to keep as it is but adding a mutual recognition clause**. Transparency and supervisory disclosure will be necessary.

6. **Drafting proposal:**

By way of derogation from point 26, the Member States may also recognise as eligible providers of unfunded credit protection, other financial institutions authorised and supervised by the competent authorities responsible for the authorisation and supervision of credit institutions and subject to prudential requirements equivalent to those applied to credit institutions. <u>When this national discretion is exercised by the competent authorities of one Member State, the competent authorities of other Member States may allow their institutions to recognise the same financial institutions as eligible providers of unfunded credit protection.</u>

51. CRM, Annex VIII, Part 2, Point 9 (a) (ii) (Directive 2006/48/EC)

"For the recognition of receivables as collateral the following conditions shall be met: (a) Legal certainty: (…)

(ii) Credit institutions must take all steps necessary to fulfil local requirements in respect of the enforceability of security interest. There shall be a framework which allows the lender to have a first priority claim over the collateral subject to national discretion to allow such claims to be subject to the claims of preferential creditors provided for in legislative or implementing provisions"

Objective of the discretion: As an exception to the general rule – according to which a receivable can only be eligible as collateral if the lender has a first priority claim over it - Member States can recognize receivables as eligible collateral where the claim of the lender is subordinated to the claims of preferential creditors if these claims are recognized in the respective national insolvency law.

1. **Overview of exercise:** This option was exercised by 73 % of Member States (of which 7% with a proviso) while 17% of the Member States decided not to implement it.

2. **Overview of responses:** 12 of the Members consider that this option should be kept in the present form and 10 consider that this option should be removed by transforming it into a general rule. 1 considers that the application of this beneficial treatment should be decided by the supervisors on a case by case basis, 1 believes that it should be subject to mutual recognition while 6 expressed no preference concerning this option. Referring to prioritization, this option is considered as fairly important by the majority of Members. 7 of the industry respondents consider that this option should be removed by transforming it into a general rule, 2 consider that it should be kept in the present form, 1 expressed no preference regarding this option and 6 of the industry respondents did not classify this option. It is difficult to extract a consensus on prioritization: 7 of the respondents classified it as very important or important, 16 as fairly important, 9 as not relevant or indifferent. For those Members that want to keep this option (for competent authorities) in the CRD, mutual recognition is widely suggested as a possible solution for convergence. This option was exercised by 80% of Member States, which overlaps with the Members that would like to keep it in the present form.

3. **Main drivers**: The main drivers for keeping this option are the differences (that will prevail) in legal systems across jurisdictions The main drivers to remove and transform this option into a general rule are the promotion of convergence, harmonization and a level playing field, the fact that a high degree of convergence already exists and the prudential adequacy of this possibility.

4. **Impact on business:** This option is not perceived as problematic by the great majority of Members.

5. **Possible solution:** Differences in insolvency legislation, in particular regarding what are considered as preferential creditors' claims, as well as differences concerning the prudential adequacy of being less restrictive in this case, makes it difficult to remove this option either by making it apply in general or by deleting it. The conditions when it is needed in domestic laws are clear, and require a local assessment of the issues mentioned. If necessary under domestic law, this would also apply if other institutions from other Member States use such a local security interest. This protection should thus be available to all credit institutions operating in a given market to prevent level playing field costs. As a result, it is proposed to **keep this national discretion in the present form with a mutual recognition clause.**

6. **Drafting proposal:**

Credit institutions must take all steps necessary to fulfil local requirements in respect of the enforceability of security interests. There shall be a framework which allows the lender to have a first priority claim over the collateral. <u>*Notwithstanding, and subject to national discretion, the claim of the lender*</u>

over the collateral may be subject to the claims of preferential creditors provided for in the national insolvency law. When this national discretion is exercised by the competent authorities of one Member State, the competent authorities of other Member States may allow their institutions to treat as a first priority claim a security interest in a Member State which is recognized as such in that Member State subject to the previously mentioned preferential creditors' claims.

52. CRM. Annex VIII, Part 3, Point 12 (Directive 2006/48/EC)

"As an alternative to using the Supervisory volatility adjustments approach or the Own Estimates volatility adjustments approach in calculating the fully adjusted exposure value (E*) resulting from the application of an eligible master netting agreement covering repurchase transactions, securities or commodities lending or borrowing transactions, and/or other capital market driven transactions other than derivative transactions, credit institutions may be permitted to use an internal models approach (…). Subject to the approval of the competent authorities, credit institutions may also use their internal models for margin lending transactions, if the transactions are covered under a bilateral master netting agreement that meets the requirements set out in Annex III, Part 7".

Objective of the discretion: This provision allows for the use the Internal Models approach, instead of the Supervisory volatility adjustments approach or the Own Estimates volatility adjustments approach, for the purpose of calculating the fully adjusted exposure value (E*) resulting from the application of an eligible master netting agreement covering certain types of transactions, subject to compliance with certain requirements. The internal models approach is a more sophisticated and risk sensitive approach and delivers, on average, lower capital requirements.

1. **Overview of exercise:** This provision has already been implemented by 96% of the Member States.

2. **Overview of responses:** 11 of the Members are of the opinion that this option should be removed by transforming it into a general rule, 9 consider that this option should be exercised on a case by case basis, 6 consider that this option should be kept in the present form, 3 propose that this option should be given to credit institutions and 1 expressed no preference regarding this subject. The majority of Members (16) consider this option to be fairly important. Besides, 5 of the Members classified it as indifferent, 4 as important, 1 as very important, 1 as not relevant and 3 did not attribute a level of priority. 6 of the industry respondents consider that this option should be given to credit institutions, 1 is of the opinion that it should be kept in the present form, 1 considers that it should be removed by transforming it into a general rule and 2 expressed no preference regarding this subject. The levels of priority are also quite diversified: 1 of the industry respondents classified it as very important, 1 as fairly important, 1 as indifferent, 1 as not relevant and 6 did not attribute a level of priority to this option. For those Members that want to keep this option (for competent

authorities) in the CRD, mutual recognition is widely suggested as a possible solution for convergence.

3. **Main drivers**: The main driver for keeping this option (as a supervisory decision) is the fact that the implementation of this option requires individual decisions by supervisory authorities depending on institution/business specificities. The argument supporting that this option should be given to institutions is that, even if the possibility of using this approach becomes a rule, the scrutiny of the applicable requirements still remains with the supervisory authority. The main drivers for removing it and transforming this option into a general rule are that a significant number of supervisors have exercised it, it is an appropriate and risk sensitive method, harmonization of eligible methods for determining exposure value (level playing field) and also that the assessment of applicable requirements still remains with the supervisors.

4. **Impact on business:** Almost all respondents assume that there would be no or limited impact on business resulting from divergent exercise of the discretion.

5. **Possible solution:** In fact this provision **is not intended to be a national discretion, but a supervisory decision** in the form of the approval of an internal model to be applied on a case by case basis that should have been implemented by all Member States (the provision says "credit institutions may be permitted" and not the Member States). It should also be applied as such. The text of the Directive should be kept unchanged and the Member States that have not yet implemented this provision as a supervisory decision to be used on a case by case basis should be urged to do so as soon as possible. The approval process should remain based on the assessment of internal risk management systems, taking into account the standards set in paragraphs 16 to 18.

6. **Drafting proposal**: No change necessary at the CRD level, but the provision should be implemented as a supervisory decision at the national level.

53. CRM, Annex VIII, Part 3, Point 19 (Directive 2006/48/EC)

"The competent authorities may allow credit institutions to use empirical correlations within risk categories and across risk categories if they are satisfied that the credit institution's system for measuring correlations is sound and implemented with integrity."

Objective of the discretion: This provision is related to the use of the internal models approach for the purpose of calculating the fully adjusted exposure value (E*) resulting from the application of an eligible master netting agreements covering repurchase transactions, securities or commodities lending or borrowing transactions, and/or other capital market driven transactions (other than derivative transactions). The internal models approach must take into account correlation effects between security positions subject to the master netting agreement as well as the liquidity of the instruments concerned. This provision permits a more risk sensitive approach by allowing the use of empirical correlations within and across risk categories considered in the internal model used to estimate the fully adjusted exposure value.

1. **Overview of exercise:** 93% of Member States exercised this option.

2. **Overview of responses:** 8 of the Members classified it as "for the supervisor to decide on a case by case basis" and 8 consider that this option should be removed by transforming it into a general rule. Additionally, 6 propose that it should be kept in the present form and 5 that this option should be given to institutions, 1 considers that it should be removed immediately and 2 expressed no preference on this subject. For the majority of the Members this option is fairly important, 6 are indifferent, for 3 it is important, for 1 not relevant and 3 did not attributed a level of priority to it. 7 of the respondents from the industry consider that this option should be given to institutions, 1 considers that it should be removed and transformed into a general rule, 2 expressed no preference regarding this subject. The levels of priority attributed are quite diversified. 1 of the industry respondents (domestic institutions) classified it as very important, 1 as fairly important, 1 as indifferent, 1 as not relevant and 6 did not attribute a level of priority to it. For those Members that want to keep this option (for competent authorities) in the CRD, mutual recognition is widely suggested as a possible solution for convergence.

3. **Main drivers**: The main driver for keeping this option (as a supervisory decision) is that its implementation requires individual decisions by the supervisors, which depend on institutions/business specificities. On the other hand, the main argument to give this option to institutions is that they should be allowed to decide, based on their specificities, whether they wish to apply provisions with a beneficial effect under conditions, given that scrutiny of the adequacy of the system remains with the supervisory authority. The main drivers to remove and transform this option into a general rule are that the majority of Member States have exercised this option and the promotion of a level playing field.

4. **Impact on business:** Almost all respondents assume that there would be no or limited impact on business resulting from divergent exercise of the discretion.

5. **Possible solution:** This provision is not intended to be a national discretion, but a supervisory decision in the form of the approval of the systems of an institution to be applied on a case by case basis and should have been implemented by all Members in this way (the provision says "the competent authority may allow" and not the Member States). In principle the text in the Directive should be kept unchanged and the Member States that have not yet implemented this provision should be urged to do so. However, as already mentioned, this provision is clearly related to the use of the internal models approach. In addition to the fact that 93% of Member States implemented this permission, the positions defined by the majority of the Members can be combined by giving firms the possibility of using empirical correlations within and across risk categories. The proposal is therefore to **delete the discretionary element of the supervisory decision,** while

noting that this choice for credit institution within the model is subject to the assessment by the supervisory authorities of institutions' systems for measuring correlations, as a component of the internal model approval process.

6. **Drafting proposal:**

The competent authorities shall allow credit institutions to use empirical correlations within risk categories and across risk categories if they are satisfied that the credit institution's system for measuring correlations is sound and implemented with integrity.

54. CRM, Annex VIII, Part 3, Point 43 (Directive 2006/48/EC)

"When debt securities have a credit assessment from a recognised ECAI equivalent to investment grade or better, the Competent Authorities may allow credit institutions to calculate a volatility estimate for each category of security."

Objective of the discretion: This option is related to the application of the Financial Collateral Comprehensive Method used to calculate the mitigating effects of financial collateral. When valuing financial collateral 'volatility adjustments' shall be applied to the market value of collateral in order to take account of price volatility. Volatility adjustments may be calculated in two ways: the "Supervisory volatility adjustments approach" and the "Own estimates of volatility adjustments approach". This option is a simplifying provision which allows credit institutions to calculate a volatility estimate for each category of security (instead of calculating it for each security) when debt securities have a credit assessment from a recognised ECAI equivalent to investment grade or better. This option is intended to provide simplicity in the use of the own estimates of volatility adjustments approach and is applicable to those institutions already complying with requirements set out in the CRD for the use of own estimates of volatility adjustments (which is not subject to authorisation).

1. **Overview of exercise:** This option was exercised by 97% of Member States.

2. **Overview of responses:** 16 Members consider that this option should be removed by transforming it into a general rule, 6 are of the opinion that this option should be kept in the present form, 4 consider that it should be an option for institutions, 3 consider that supervisors should decide on a case by case basis and 1 expressed no preference regarding this topic. For the majority of Members this option is fairly important, 6 are indifferent, for 4 it is important, for 1 it is not relevant while 3 did not attribute a level of priority to it. 5 of the industry respondents consider that this option should be kept as an option for credit institutions, 2 consider that this option should be removed by transforming it into a general rule, 1 is of the opinion that it should be kept in the present form, and 2 expressed no preference on this subject. The levels of priority attributed are quite diversified: 1 of the

industry respondents (domestic institutions) classified it as very important, 1 as fairly important, 1 was "indifferent", for 1 not relevant and 6 did not attribute a level of priority to it. 6 other industry respondents did not take a position on this option.

3. **Main drivers**: The main drivers for keeping this option are that its implementation is subject to the conditions of the institutions. The argument for giving this option to institutions is that they should be allowed to decide, based on their specificities, whether they wish to apply provisions with a beneficial effect under conditions. The main drivers to remove and transform this option into a general rule are the fact that a high degree of convergence already exists, the promotion of convergence and a level playing field, and to avoid an additional burden for institutions.

4. **Impact on business:** Almost all respondents assume that there would be no or limited impact on business resulting from divergent exercise of the discretion.

5. **Possible solution:** This national discretion was analysed together with national discretion 53. The solutions proposed by the majority of the Member States were to remove the option by transforming it into a general rule or to give the option for credit institutions. Once the provision allows for a less demanding approach (whose application is still subject to the fulfilment of quantitative and qualitative criteria set out in the CRD), those two alternatives are similar in practical terms. The proposal is, therefore, similar and is to give the **option for credit institutions.**

6. **Drafting proposal:**

When debt securities have a credit assessment from a recognised ECAI equivalent to investment grade or better, credit institutions may calculate a volatility estimate for each category of security.

55. CRM, Annex VIII, Part 3, Point 72 (Directive 2006/48/EC)

"By way of derogation, until 31 December 2012 the competent authorities may, subject to the levels of collateralisation indicated in Table 5: (a) allow credit institutions to assign a 30 % LGD for senior exposures in the form of Commercial Real Estate leasing; (b) allow credit institutions to assign a 35 % LGD for senior exposures in the form of equipment leasing; and (c) allow credit institutions to assign a 30 % LGD for senior exposures secured by residential or commercial real estate. At the end of this period, this derogation shall be reviewed."

Objective of the discretion: This option allows for a more permissive treatment: it provides for the assignment of lower levels of LGD to senior exposures in the form of Commercial Real Estate leasing and of equipment leasing, which result in lower capital requirements. The objective of this (transitional) option is not only to smooth the impact of the introduction of the new capital adequacy regime but also to accommodate the fact that the original

LGDs may need to be recalibrated in 2012, taking into account the experience accumulated during that period after CRD implementation

1. **Overview of exercise:** 44% of the Member States exercised this option.

2. **Overview of responses:** 12 of the Members consider that this option should be kept in the present form, 7 consider that this option should be removed after a transitional period while 3 propose that it should be removed immediately. 2 consider that this option should be kept subject to mutual recognition, 1 classified it as "for supervisor to decide on a case by case basis" and 5 expressed no preference regarding this option. The levels of priority attributed are quite diversified. 9 of the Members classified it as fairly important, 6 as indifferent, 13 (domestic institutions) as very important, 4 as important, 4 as not relevant and 3 did not attribute a level of priority to it. 6 of the industry respondents consider that this option should be removed by transforming it into a general rule, 3 consider that it should be kept in the present form, 1 considers that it should be kept subject to mutual recognition, 1 considers that it should be removed after a transitional period, and 2 expressed no preference regarding it. For 4 of the industry respondents this option is very important, for 1 fairly important, 1 is indifferent, for 1 it is not relevant and 6 did not attribute a level of priority to it. 5 did not take a position on this option.

3. **Main drivers**: The main drivers for keeping this option (as a supervisory decision) are the fact that is already a transitional provision, market specificities (namely lack of liquidity in the commercial real estate market) and business specificities (higher recovery rates for leases). The main drivers for removing it (after a transition period) are that this option is already a transitional provision, the preferential LGD is not justified on the basis of risk and this treatment is only relevant during the first years after implementation of the new regulatory framework. The reason presented for transforming this option into a general rule is, essentially, the avoidance of level playing field distortions.

4. **Impact on business:** This option is perceived as relatively problematic. The divergent exercise of this option has an impact on business, namely on the level playing field.

5. **Possible solution:** Mutual recognition is widely suggested as a possible solution for convergence until its expiration at the end of 2012. Despite the fact that this is a less prudent option and there are no real local market characteristics driving the choice, given its transitional character, and the fact that the content itself has to be reviewed in due course, this option should be **kept in the present form, including the review clause**. In 2012 (and thus before the end of its validity), it should be evaluated whether the original levels of LGD are more or less appropriate and an impact assessment should be conducted on that question. In so far as commercial real estate leasing and senior exposures secured by residential or commercial real estate are concerned; the decision on the application of this more favourable treatment may depend strongly on market and business specificities. At such time it should therefore be considered whether – if the

discretion is extended - the introduction of a mutual recognition clause might help to minimise level playing field distortions.

6. **Drafting proposal**: To clarify that the provision should be reviewed before the end of its validity.

By way of derogation, until 31 December 2012 the competent authorities may, subject to the levels of collateralisation indicated in Table 5: (a) allow credit institutions to assign a 30 % LGD for senior exposures in the form of Commercial Real Estate leasing; (b) allow credit institutions to assign a 35 % LGD for senior exposures in the form of equipment leasing; and (c) allow credit institutions to assign a 30 % LGD for senior exposures secured by residential or commercial real estate. Before the end of this period, this derogation shall be reviewed"

56. CRM, Annex VIII, Part 3, Para 89 (Directive 2006/48/EC)

"The competent authorities may extend the treatment provided for in Annex VI, Part 1, points 4 and 5 to exposures or parts of exposures guaranteed by the central government or central bank, where the guarantee is denominated in the domestic currency of the borrower and the exposure is funded in that currency."

Objective of the discretion: This option allows for a more permissive treatment since it offers the possibility of applying a 0% risk weight to the exposures or parts of exposures guaranteed by the central government or central bank where the guarantee is denominated in the domestic currency of the borrower and the exposure is funded in that currency, introducing consistency with the (more favourable) treatment available in the Standardised approach.

1. **Overview of exercise:** This option was exercised by 86% of Member States.

2. **Overview of responses:** 16 Members consider that this option should be removed by transforming it into a general rule, 9 consider that it should be kept in the present form, 2 classified it as "for supervisor to decide on a case by case basis", 1 considers that it should be kept subject to mutual recognition, 1 considers that this option should be given to credit institutions and 1 has expressed no preference regarding this option. 11 of the Members classified this option as important, 7 as fairly important, 6 as very important, 2 as indifferent, 1 as not relevant and 3 did not attribute a level of priority to it. 7 of the industry respondents consider that this option should be removed by transforming it into a general rule, 2 are of the opinion that it should be kept in the present form, 1 has expressed no preference regarding this option. 2 of the industry respondents classified this option as fairly important, 1 as very important, 1 as not relevant and 6 did not attribute a level of priority to it.

3. **Main drivers**: The main drivers for keeping this option (as a supervisory decision) are that its implementation is subject to supervisors' specific evaluation. The main drivers for removing this option by transforming it into a general rule are the promotion of convergence given that a high degree of convergence already exists, to promote a level playing field and the prudential adequacy of this treatment (subject to requirements).

4. **Impact on business:** This option is perceived as relatively problematic –the divergent exercise of this option has potential impact on business, namely on the level playing field.

5. **Possible solution:** This option is not a national discretion but a supervisory decision to be applied on a case by case basis. In principle, the implementation of this provision as a supervisory decision could be a solution. However, and despite the diversity of classifications resulting from the questionnaire, given that this option was exercised by 86% of Member States and allows for a more favourable treatment, the solution proposed is to transform it into an **option for credit institutions**. Given the conditions presented, this does not appear to have a negative prudential effect.

6. **Drafting proposal:**

<u>Credit Institutions may</u> extend the treatment provided for in Annex VI, Part 1, points 4 and 5 to exposures or parts of exposures guaranteed by the central government or central bank, where the guarantee is denominated in the domestic currency of the borrower and the exposure is funded in that currency.

Area: Securitisation

57. Securitisation, Article 152 (10) (b) (Directive 2006/48/EC)
"Where the discretion referred to in paragraph 8 is exercised, the following shall apply in relation to the treatment of exposures for which the Standardised Approach is used: (a). … (b). Title V, Chapter 2, Section 3, Subsection 4 concerning the treatment of securitisation may be disapplied by competent authorities.' **Objective of the discretion**: To allow a transitional period before the treatment on securitisation could take effect. It expired naturally at the end of 2007.

1. **Overview of exercise:** 73% of Member States have applied this discretion, 17% have not, 7% have not yet decided and for 3% this discretion is not applicable.

2. **Overview of responses**: 5 Member States wish to keep the discretion in its present form. 1 wishes to keep it as an option for the supervisor to decide on a case by case basis, 1 wishes to keep it subject to mutual recognition. 3 wish to remove it completely from the CRD (2 immediately and 6 after a

transitional period). 3 wish it to be transformed into a general rule while 10 have no preference. 6 of the industry responses would like to keep it in the present form and another 2 to remove it completely from the CRD after a transitional period. For the majority of both Members and industry respondents this national discretion is classified as indifferent.

3. **Main drivers:** The national discretion was put in place in order to allow a transitional period before the treatment on securitisation could take effect. The rationale was to take into account e.g. the non-availability of external ratings or other market specificities. It expired naturally at the end of 2007.

4. **Impact on business:** Nearly all respondents assume that there is no impact of this national discretion (as it has expired).

5. **Possible solution:** This discretion expired at the end of 2007; therefore it is proposed to **delete the provision**.

6. **Drafting solution:** Delete Article 152 (10) (b) of Directive 2006/48/EC.

58. Securitisation, Annex IX, Part 4, Para 30 (Directive 2006/48/EC)

"In the case of securitisations subject to an early amortization provision of retail exposures which are uncommitted and unconditionally cancellable without prior notice and where the early amortization is triggered by a quantitative value in respect of something other than the three months average excess spread, the competent authorities may apply a treatment which approximates closely to that prescribed in points 26 to 29 for determining the conversion figure indicated."

Objective of the discretion: To simplify one computation, in certain cases, where the results only change marginally (i.e. the national discretion is capital-neutral).

1. **Overview of exercise:** 47% of the Member States are exercising this discretion with a further 10% exercising it with provisos.

2. **Overview of responses:** 10 of the Members wish to retain the discretion in its present form; 6 want it to be decided on a case by case basis by supervisors; 1 wishes to retain it subject to mutual recognition; 2 want it to be kept as an option for credit institutions. 1 of the Members wishes to remove it completely from the CRD, while 1 wishes to transform it into a general rule. 9 have no preference. Among the industry's answers, 6 favour keeping it as an option for credit institutions. The weighting of importance is generally equally distributed with a bias for fairly important and indifferent. Suggested solutions include adoption of common supervisory practices; mutual recognition; setting minimum conditions; and transforming it into a general rule.

3. **Main drivers:** Almost all answers (coming from both those wanting to keep, and those wanting to delete, the national discretion) recognize its usefulness

and point towards the need for the national authorities to be able to take into account other triggers than the excess spread.

4. **Impact on business:** The majority of respondents perceive no impact from the divergent exercise of this national discretion currently (since, in most Member States no securitization framework is in place). Those answers (five) identifying some impact, realise that theoretically and potentially it could impact on the level playing field.

5. **Possible solution:** This national discretion is currently only relevant for the UK market. However to ensure consistency and a level playing field, the provision should be applicable either everywhere or nowhere. As the alternative approach is understood to be capital neutral and prudentially sound, though less clear, the proposal is to harmonize the possibility of using either method across the EU where there is a securitisation regime. This could be phrased as a supervisory decision, but the main components of the discretion are decided across the board subject to normal supervisory scrutiny in regular supervision. As a result, the proposal is to **delete the discretionary component of the provision**. In any case the provision of point 31, which follows immediately after the national discretion, already provides for other Members' opinions to be heard so that further convergence on a case by case basis can be achieved and would therefore allow supervisory authorities flexibility to decide the details of such a treatment on a case by case basis.

6. **Drafting proposal:**

> *'In the case of securitisations subject to an early amortisation provision of retail exposures which are uncommitted and unconditionally cancellable without prior notice and where the early amortisation is triggered by a quantitative value in respect of something other than the three months average excess spread, a treatment which approximates closely to that prescribed in points 26 to 29 for determining the conversion figure indicated shall apply.'*

59. Securitisation, Article Annex IX, Part 4, Para 53 (last sentence) - (Directive 2006/48/EC)

"(…) For securitisations involving retail exposures, the competent authorities may permit the Supervisory Formula Method to be implemented using the simplifications: h=0 and v=0. (…)"

Objective of the discretion: To simplify the computation of the Supervisory Formula method in the case of securitisations involving retail exposures, where it would result in immaterial differences to capital levels (i.e. the national discretion is capital-neutral).

1. **Overview of exercise:** 80% of Member States apply this discretion with a further 10% applying it with provisos; 7 % do not apply it and 3% have not yet decided.

2. **Overview of responses:** 5 of the Members wish to retain the discretion in its present form; 2 Members wish for it to be decided by supervisors on a case by case basis and another 2 wish for it to be kept as an option for credit institutions. 13 wish to transform it into a general rule and 8 have no preference. Dominant among industry respondents (6) is the wish to retain it as an option for credit institutions. In terms of importance the majority of both Members and the industry see this as either fairly important or indifferent. Four possible solutions were identified: give discretion to credit institutions; adoption of common supervisory practices; mutual recognition setting minimum conditions; and transforming it into a general rule.

3. **Main drivers:** No respondent wishes to remove this national discretion completely. Both those wishing to retain it as is and those wishing to transform it into a general rule point to the same rationale: the simplification is useful for retail securitisations (i.e. where N is large, and therefore both 'h' and 'v' tend to 0 anyway). On the other hand, if the discretion is kept, there are concerns about the level playing field and the use of the discretion by institutions with cross-border businesses.

4. **Impact on business** Answers here are identical to the previous national discretion, i.e. potentially and theoretically no real impact (as no securitisation frameworks are in place).

5. **Possible solutions** Of the solutions identified in the responses to the questionnaire two are deemed most viable: to delete the provision completely (once the systems are programmed to calculate the Formula, when presumably they should not need to use this national discretion) or to delete the discretionary component of the national discretion, effectively making this an option for the credit institutions. These solutions would allow for flexibility (especially since the use of the national discretion would result in immaterial changes to capital levels) and for the simplification to take place in a consistent manner across Member States. The tentative proposal is to transform the provision into **an option for credit institutions. CEBS welcomes input from respondents firstly on the need to keep this provision and secondly on the current proposal.** Input is also welcomed on a possible definition of 'predominantly'.

6. **Drafting proposal:** Amendment of the last sentence.

> *For securitisations involving <u>predominantly retail exposures,</u> the Supervisory Formula Method may be implemented by using the simplifications: h=0 and v=0.*

<u>Area: Operational Risk</u>

60. Op Risk, Article 102.4 & Annex X, Part 4, Points 1 and 2 (Directive 2006/48/EC)
"Competent authorities may allow credit institutions to use a combination of approaches in accordance with Annex X, Part 4."

Objective of the discretion: The objective of the discretion, when applied, is to allow a pragmatic and practical approach to operational risk requirements. That is, it allows for practical implementation of the Advanced Measurement Approach ("AMA") approach by allowing parts of the risk portfolio to be captured by The Standardised Approach ("TSA") or Basic Indicator Approach ("BIA"). When applied, it allows credit institutions flexibility in the application of the AMA approach or in exceptional circumstances, the TSA approach. Exceptional circumstances would include for example, the occurrence of a merger or acquisition. The discretion, when applied, allows a more permissive treatment but one which is grounded in a practical approach.

1. **Overview of exercise:** 87% of Member States have applied this discretion with a further 10% applying the discretion with provisos. Therefore, up to 97% of Member States have decided that they may allow institutions to use a combination of approaches to Operational Risk subject to conditions laid out in the CRD.

2. **Overview of responses:** 8 Members wish to keep the national discretion in its present form. 4 wish it to be decided on a case by case basis by supervisors. 1 wishes fit to be subject to Mutual Recognition. 4 wish it to be kept as an option for credit institutions. 1 Member wishes to remove the national discretion completely from the CRD immediately. 10 wish to transform it into a general rule and remove the other option(s). Industry responses are consistent with keeping the option as an option for credit institutions or transforming it into a general rule. They also wish to delete sub-section 2 which would remove the competent authorities' oversight over AMA implementation.

3. **Main drivers**: Firstly, the explanations, which inform the "main drivers", show that the interpretation of the classification is key to the exercise. It seems that respondents wishing to keep the discretion as an option for credit institutions or remove it by transforming it into a general rule have the same goal, albeit with a different interpretation. It also seems that those who wish to keep it in its present form are aligned with those who wish to decide on a case by case basis. There are no arguments presented on either a market specificities or business specificities basis for not applying the discretion.

4. **Impact on business:** Is generally viewed from the perspective of institutions if they were not allowed to use a combination of approaches. The option is seen as more of a restraint from both a cross border and cost basis where different rules apply. It is also seen as a deterrent to implementing the more advanced approaches.

5. **Possible solution:** It is unclear how transforming the option into a general rule would operate practically. It is difficult to see how the text could be amended to say that "institutions shall use a combination of approaches" without specifying an exhaustive list of circumstances. Giving the discretion as an option for credit institutions is a viable path for progress, as Annex X details the qualifications in respect of the option; this also achieves convergence and is advantageous to cross-border groups or in exceptional cases, for example, mergers. It should be noted that the set of criteria is not considered to be sufficiently strong by all Members. However, the CRD allows

for a stricter application of the criteria and the competent authorities also retain oversight regarding the applicability of the combined use of methodologies in the context of the approval process. The proposal is thus to give the **option for credit institutions**. It is noted that this proposal may prejudice the comparability between institutions.

6. **Drafting proposal:** Convergence can be achieved by amending the Directive text as stated and it should be a relatively straightforward change given the relatively common implementation across Members.

Credit Institutions may use a combination of approaches subject to compliance with the requirements set out in Annex X, Part 4.

61. Op Risk, Article 104.3 (Directive 2006/48/EC)

"For certain business lines, the competent authorities may under certain conditions authorise a credit institution to use an alternative relevant indicator for determining its capital requirement for operational risk as set out in Annex X, Part 2, points 5 to 11."

Objective of the discretion: The objective of the discretion, when applied, is to allow for an improved basis for assessing operational risk in those institutions meeting the qualifying criteria. The discretion, when applied, allows a more permissive treatment.

1. **Overview of exercise:** 60% of Member States have applied this discretion with a further 3% applying the discretion with provisos. Therefore, up to 63% of Member States have decided that they may allow institutions to use the Alternative Standardised Approach to Operational Risk.

2. **Overview of responses:** 8 Members wish to keep the national discretion in its present form. 4 wish it to be decided on a case by case basis by supervisors. 2 wish it to be kept as an option for credit institutions. 2 Members wish to remove the national discretion completely from the CRD immediately and 2 more after a transition period. 3 wish to transform it into a general rule and remove the other option(s). Industry responses are consistent with keeping the option as an option for credit institutions or transforming it into a general rule.

3. **Main drivers**: Competent authorities that have not applied the discretion have argued that the Alternative Standardised Approach ("ASA") has no substantial supporting argument in their relative jurisdictions. A lot of Members have either applied the discretion, albeit with no institutions making use of the ASA, or did not apply it as no institutions comply with the criteria. Other Members have quoted market/business specificities as a reason for applying the discretion and/or keeping the discretion in its present form as well as level playing field/ competitiveness concerns with third country institutions which may use ASA as described in the Basel 2 text.

4. **Impact on business:** Is viewed from the perspective of those institutions that have implemented the ASA. It would have a significant impact to remove the

approach for those institutions that have implemented the ASA already. However, it is not entirely clear how many institutions use it which may lead to changes following the consultation.

5. **Possible solution:** In CEBS's view this provision was never intended to be a national discretion, but a supervisory decision to be applied on a case by case basis that should have been implemented as such by all Member States (the provision says "the competent authority may waive" and not the Member States). It should also be applied as such. In principle the text in the Directive should be kept unchanged and the Member States that have not yet implemented this provision as a supervisory decision to be used on a case by case basis should be urged to do so as soon as possible. However there is different reasoning to consider when proposing a possible solution: i) in one hand some Members States questioned the risk sensitivity of the discretion and expressed their concerns on its use since in their view the conditions can never be satisfactorily fulfilled; ii) on the other hand, Article 104.3, as well as the conditions of implementation contained in Annex X, clearly bestows supervisory oversight of the ASA approach on the competent authorities (as stated in Annex X, Part 2, Point 11, credit institutions wishing to implement the ASA, among other requirements, must demonstrate to the competent authorities that the ASA provides an improved basis for assessing operational risk (which in general only happens in emerging countries) and so the discretion is relevant at least on a consolidated basis. In addition, since the possibility to use the ASA approach exists in third countries, banking groups conducting business within and outside the EU might face difficulties if this possibility is not available in the EU. Furthermore, the ASA approach is already being applied in a number of cases and it is CEBS perception that its deletion would bring more costs than benefits. Taking into account these considerations CEBS is proposing to **implement the provision as a supervisory decision to be applied on a case by case basis. Respondents are invited to provide their views on the costs and benefits of CEBS's proposal.**

6. **Drafting proposal**: No change necessary at the CRD level, but it should be implemented as a supervisory decision at the national level.

7. **Other remarks:** The discretion in Article 104.3 refers to conditions set out in Annex X, part 2. Actually the Annex also includes the discretion which creates a sort of duplication. **(See also provision 63)**

62. Op Risk, Article 105.4 (Directive 2006/48/EC)

"Where an EU parent credit institution and its subsidiaries or the subsidiaries of an EU parent financial holding company use an Advanced Measurement Approach on a unified basis, the competent authorities may allow the qualifying criteria set out in Annex X, Part 3 to be met by the parent and its subsidiaries considered together."

Objective of the discretion: The objective of the discretion, when applied, is to allow for a practical approach to approving AMA applications for cross-border banking groups. The discretion, when applied, allows a more permissive treatment, but one which is pragmatic and cognisant of the home/host relationship.

1. **Overview of exercise:** 80% of Member States have applied this discretion with a further 13% applying the discretion with provisos. Therefore, up to 93% of Member States have decided that they may allow the qualifying criteria for AMA applications to be met by the parent and its subsidiaries considered together.

2. **Overview of responses:** 6 Members wish to keep the national discretion in its present form. 8 wish it to be decided on a case by case basis by supervisors. 1 wishes it to be subject to mutual recognition. 1 Member wishes to remove the national discretion completely from the CRD immediately. 12 wish to transform it into a general rule and remove the other option(s). Industry responses are consistent with keeping the option as an option for credit institutions or transforming it into a general rule.

3. **Main drivers**: Members' explanations deem the option to be practical and in accordance with Article 129 to reduce the supervisory burden. A lot of responses from other Members and industry recognise that it is difficult to meet the AMA criteria at subsidiary level.

4. **Impact on business**: From the responses received it is not clear; a few respondents expect some impact, a few do not.

5. **Possible solution:** Responses from 11 Members indicated a preference for removing the option by transforming it into a general rule; however removing the option may deny institutions the group-wide basis approach. Therefore, convergence should be achieved through keeping the option **for supervisors to decide on a case by case basis** in the context of the **supervisory approval process**. In fact it is our opinion that this provision is not intended to be a national discretion but a supervisory decision to be applied on case by case basis that should have been implemented by all Member States. It should also be applied as such. The text in the Directive should be kept unchanged and the Member States that have not yet implemented this provision as a supervisory decision to be used on a case by case basis should be urged to do so as soon as possible. A large majority of Member States have chosen to apply the discretion and competent authorities retain oversight through the AMA approval process as well as in conjunction with Article 129 home/host interaction and CEBS home/host guidelines.

6. **Drafting proposal:** No change necessary at the CRD level, but the provision should be implemented as a supervisory decision at the national level.

63. Op Risk, Annex X, Part 2, Point 3 and 5 (Directive 2006/48/EC)

Point 3: "Competent authorities may authorise a credit institution to calculate its capital requirement for operational risk using an alternative standardised approach, as set out in points 5 to 11."

Objective of the discretion: The objective of the discretion, when applied, is to allow for an improved basis for assessing the operational risk in those institutions meeting the qualifying criteria. The discretion, when applied, allows a more permissive treatment.

1. **Overview of exercise:** 60% of Member States have applied this discretion with a further 3% applying the discretion with provisos. Therefore, up to 63% of Member States have decided that they may allow institutions to use the Alternative Standardised Approach to Operational risk.

2. **Overview of responses:** 8 Members prefer to keep the discretion in the present form as do 2 respondents from the industry. 5 Members would prefer to leave it to supervisors' decision on a case by case basis. 3 Members would like to remove the provision while 2 wanted to transform it into a general rule. 6 industry respondents and 2 Members would prefer to transform it into an option for credit institutions.

3. **Main drivers**: Competent authorities that have not applied the discretion have argued that the Alternative Standardised Approach (ASA) has no substantial supporting argument in their jurisdictions.

4. **Impact on business:** Is viewed from the perspective of those institutions that have implemented the ASA. It would have a significant impact to remove the approach for those institutions that have implemented the ASA already.

5. **Possible solution:** This is the same discretion as Article 104.3 and they should therefore be analysed together. **See provision 61** for the reasoning of the possible solutions **CEBS is proposing to implement the provision as a supervisory decision to be applied on a case by case basis. Respondents are invited to provide their views on the costs and benefits of CEBS's proposal.**

6. **Drafting proposal:** No change necessary at the CRD level, but it should be implemented as a supervisory decision at the national level.

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

"By way of derogation from paragraph 1, competent authorities may allow investment firms that are not authorised to provide the investment services listed in points 3 and 6 of Section A of Annex I to Directive 2004/39/EC to provide own funds which are always more than or equal to the higher of the following: (a) the sum of the capital requirements contained in points (a) to (c) of Article 75 of Directive 2006/48/EC; and (b) the amount laid down in Article 21 of this Directive."

Objective of the discretion: The objective of the discretion, when applied, is to allow for a proportionate approach to operational risk requirements for those investment firms with a limited licence. The discretion, when applied, allows a more permissive treatment, but one which is proportionate to the limited licence investment firms.

1. **Overview of exercise:** 73% of Member States have applied this discretion. Therefore, up to 73% of Member States have decided that investment firms with a limited licence have to provide own funds which are always more than or equal to the higher of the capital requirement for credit and market risk or 25% of the preceding year's fixed overheads.

2. **Overview of responses:** 11 Members wish to keep the national discretion in its present form. 2 wish it to be decided on a case by case basis by supervisors. 3 wish it to be an option for investment firms. 1 Member wishes to remove the national discretion completely from the CRD immediately. 5 wish to transform it into a general rule and remove the other option(s). Industry responses are consistent with keeping the option as an option for investment firms or transforming it into a general rule.

3. **Impact on business:** Members have applied the discretion on the basis of proportionality, as not granting the waiver would have a disproportionate impact on qualifying investment firms. This will impact on a small number of limited authorisation investment firms on a disproportionate basis.

4. **Possible solution:** Keeping the discretion **for supervisors to decide on a case by case basis** is the appropriate approach to the discretion and to convergence. In fact this provision is not intended to be a national discretion, but a supervisory decision to be applied on a case by case basis that should have been implemented by all Member States (the provision says "the competent authority may allow" and not the Member States). It should also be applied as such. The text in the Directive should be kept unchanged and the Member States that have not yet implemented this provision as a supervisory decision to be used on a case by case basis should be urged to do so as soon as possible. A majority of respondents have chosen to apply the discretion on the basis of proportionality. Convergence should be easily achieved given the number of Members in the majority and the lack of argument presented in response to the questionnaire against applying the discretion.

5. **Drafting proposal:** No change necessary at the CRD level, but the provision should be implemented as a supervisory decision at the national level.

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

"By way of derogation from paragraph 1, competent authorities may allow investment firms which hold initial capital as set out in Article 9, but which fall within the following categories, to provide own funds which are always more than or equal to the sum of the capital requirements calculated in accordance with the requirements contained in points (a) to (c) of Article 75 of Directive 2006/48/EC and the amount laid down in Article 21 of this Directive (…)"

Objective of the discretion: The objective of the discretion, when applied, is to allow for a proportionate approach to operational risk requirements for those investment firms with limited activity. The discretion, when applied, allows a more permissive treatment, but one which is proportionate to the limited activity investment firms.

1. **Overview of exercise:** 50% of Member States have applied this discretion, and 3% with a proviso. Therefore 53% of Member States have decided that investment firms with limited activity have to provide own funds which are always more than or equal to the higher of the capital requirement for credit and market risk or 25% of the preceding year's fixed overheads.

2. **Overview of responses:** 7 Members wish to keep the national discretion in its present form. 3 wish it to be decided on a case by case basis by supervisors. 1 wishes it to be an option for investment firms. 3 Members wish to remove the national discretion completely from the CRD immediately. 2 wish to transform it into a general rule and remove the other option(s). Industry responses are consistent with keeping the option as an option for investment firms or transforming it into a general rule.

3. **Impact on business:** Members have applied the discretion on the basis of proportionality and the disproportionate impact on investment firms of this nature. This will impact on a small number of limited activity investment firms on a disproportionate basis.

4. **Possible solution:** There is a strong correlation between those Members who wish to transform the rule and those who wish to keep the rule as an option for investment firms. Keeping it as an **option for investment firms** allows for a proportionate impact on business and convergence, but could benefit from further input from the industry to inform the impact assessment. One country would like to see the actual conditions of the discretion changing to become more stringent, however, this is contrary to the general consensus on proportionality. A majority of respondents have chosen to apply the discretion on the basis of proportionality. Convergence should be easily achieved given the number of Members in the majority and the lack of argument presented thus far against applying the discretion.

5. **Drafting proposal:**

> *"By way of derogation from paragraph 1, <u>investment firms</u> which hold initial capital as set out in Article 9, but which fall within the following categories, <u>may</u> provide own funds which are always more than or equal to the sum of the capital requirements calculated in accordance with the requirements contained in points (a) to (c) of Article 75 of Directive 2006/48/EC and the amount laid down in Article 21 of this Directive:(…)"*

Area: Qualifying holdings outside the financial sector

> **66. Qualifying holdings, Article 122.1 (Directive 2006/48/EC)**
>
> "The Member States need not apply the limits laid down in Articles 120(1) and (2) to holdings in insurance companies as defined in Directives 73/239/EEC and 2002/83/EC, or in reinsurance companies as defined in Directive 98/78/EC."

Objective of the discretion: This national discretion could be considered as a 'proxy LE' rule. It could appear as being permissive (but see below: other safeguards, solutions are in place).

1. **Overview of exercise:** 70% of Member States have applied the discretion; 27% have not; 3% have not yet finally decided.

2. **Overview of responses:** 8 Member States wish to keep it in its present form; 4 wish it to be decided by supervisors on a case by case basis; 2 wish to retain it as an option for credit institutions. 2 wish to remove it completely from the CRD, 1 immediately, and 10 wish to transform it into a general rule. 3 have no preference. The dominant view among industry respondents is for transforming it into a general rule. The weighting of importance is generally equally distributed with a bias for important and fairly important. Possible solutions included deleting it; adoption of common supervisory practices; and turning it into a general rule obliging Member States to exempt insurance undertakings from the general limits on qualifying holdings.

3. **Main drivers:** The main rationale mentioned in the responses for keeping this national discretion seems to be the need for authorities to have flexibility to face national and particular business and market specificities. The main rationale for turning it into a general rule is that insurance sector undertakings are also subject to prudential supervision and that turning this into a general rule would be more consistent with the conglomerates' regime.

4. **Impact on business:** A minority of Members (7) identified the potential for an unlevel playing field for cross-border business due to a different composition of own funds.

5. **Possible solution:** Prudential supervision of insurance undertakings and the material holdings deductions in the Conglomerates directive seem to cover any need for 'flexibility'. The proposal is to **delete the discretionary part of the provision.**

6. **Drafting proposal:**

The limits laid down in Articles 120(1) and (2) shall not apply to holdings in insurance companies as defined in Directives 73/239/EEC and 2002/83/EC, or in reinsurance companies as defined in Directive 98/78/EC.

67. Qualifying holdings, Article 122.2 (Directive 2006/48/EC)

"The Member States may provide that the competent authorities are not to apply the limits laid down in Article 120 (1) and (2) if they provide that 100 % of the amounts by which a credit institution's qualifying holdings exceed those limits shall be covered by own funds and that the latter shall not be included in the calculation required under Article 75. If both the limits laid down in Article 120(1) and (2) are exceeded, the amount to be covered by own funds shall be the greater of the excess amounts."

Objective of the discretion: To continue to allow a flexible *but still prudent* method of managing qualifying holdings for those market structures where credit institutions have relatively large qualifying holdings.

1. **Overview of exercise:** 60% of Member States have exercised this discretion with a further 3% exercising it with provisos. 33% have not exercised it and a further 3% have not yet decided.

2. **Overview of responses:** 13 Members wish to keep it in its present form; 3 wish to retain it for the supervisor to decide on a case by case basis; 1 wishes to retain it as option for credit institutions. 3 Members wish to remove it completely from the CRD. 7 wish to transform it into a general rule. 3 have no preference. Among the industry the two dominant opinions are in favour of retaining it as an option for credit institutions and transforming it into a general rule. The weighting of importance is essentially equally distributed with a bias for fairly important and indifferent. Possible solutions include: deletion, transformation into a general rule, setting an expiration date, and mutual recognition.

3. **Main drivers:** Similarly to the previous discretion, the need for authorities to have flexibility to deal with national and business/market specificities is offered as a rationale for keeping the national discretion as is. Those supporting its transformation into a general rule suggest that deduction of the excess from own funds is prudential enough to justify a uniform treatment and point to the fact that there is a tendency for convergence among Members' practices on this topic.

4. **Impact on business:** Similarly to the previous national discretion, a minority of Members (7) identify a potentially unlevel playing field for cross-border businesses.

5. **Possible solution:** This national discretion is stating that credit institutions must either keep within limits, or meet the extra position by keeping capital. Although this national discretion entails a supervisory decision, it should and will be applied across the board and not on a case by case basis as it relates to the banking model in each jurisdiction. The tentative proposal is to **keep this national discretion in its current form**.

6. **Drafting proposal**: No change is necessary.

7. **Other remarks**: CEBS has contributed to the review of the large exposures regime with its Advice to the European Commission, which recommends that a temporary breach in the Banking Book should be allowed only in specific and extraordinary circumstances provided the excess is deducted from own funds. However, it may be appropriate to have a differentiated approach to the breach of limits in the field of qualifying holdings outside the financial sector, because the rational underpinning of the two rules is quite different. In the case of the large exposures regime, the treatment of the breach of limits is driven by prudential concerns, while in the case of qualifying holdings outside the financial sector this treatment is related to the banking model in each jurisdiction.

Area: Transitional provisions

General remark: In view of the time needed for any legislative process CEBS's proposal is to **keep in their present form till the end of the transition period all transitional national discretions which expire before the end of 2011.** This proposal also takes into consideration the very short time remaining for use of the provisions in such conditions.

68. Transitional, Article 153, First sentence (Directive 2006/48/EC)

"In the calculation of risk weighted exposure amounts for exposures arising from property leasing transactions concerning offices or other commercial premises situated in their territory and meeting the criteria set out in Annex VI, Part 1, point 54, the competent authorities may, until 31 December 2012 allow a 50 % risk weight to be assigned without the application of Annex VI, Part 1, points 55 and 56."

Objective of the discretion: This national discretion temporarily allows Member States to assign a preferential 50% risk weight (50% instead of 100%) to the full amount of certain exposures related to property leasing transactions concerning offices or other commercial premises situated in their territories for SA institutions without the application of special conditions. The exercise of this discretion is based on local market conditions.

1. **Overview of exercise:** The majority of Member States (77%) do not apply this option while 23 % of the Members exercise it.

2. **Overview of responses**: 14 Members indicated that this option has little importance or was not relevant to them. On the contrary, this option is very important for 2 Members. The main views expressed were to keep it in its present form (10 Members and 2 industry representatives); to keep it subject to Mutual Recognition (1 Member and 5 industry representatives); to remove the option (15 Members and 1 industry representative). On one hand the majority of Members are in the favour of removing this more flexible provision for the treatment of certain leasing transactions immediately or at the end of the transition period. On the other hand, this national discretion is very important for several jurisdictions where commercial real estate leasing business is concentrated. This national discretion seems to be important to some industry respondents which proposed as a possible solution binding mutual recognition during the transition period.

3. **Main drivers:** The majority of Members are of the opinion that this transitional provision should end automatically at the specified date. This option is driven by market conditions and should be kept until the specified date.

4. **Impact on business:** The majority of respondents from the membership and the industry have not indicated direct implications for their business although a specific segment of industry's respondents classify this discretion as "very

important" and perceive a big impact on their business if the discretion is deleted.

5. **Possible solutions:** Given the relevance of this national discretion to some Members and a specific segment of the industry and also that this national discretion is rooted in local market conditions, the proposal is to **keep the provision till the end of the transition period subject to binding mutual recognition**. This means that the decision taken by the competent authority where the collateral is located should be automatically recognised by other authorities. The importance of the national discretion for the industry should be reassessed prior to the expiration date of transition period.

6. **Drafting proposal:** Add a clause on binding mutual recognition to the CRD text.

When this discretion is exercised by the competent authorities of Member State, all institutions subject to this directive, irrespective of their location, may assign 50% risk weight to such exposures in that Member State without the application of Annex VI, Part 1, points 55 and 56

69. Transitional, Article 153, Second sentence (Directive 2006/48/EC)

"Until 31 December 2010, competent authorities may, for the purpose of defining the secured portion of a past due loan for the purposes of Annex VI, recognise collateral other than eligible collateral as set out under Articles 90 to 93."

Objective of the discretion: This is a more permissive national discretion which temporarily allows the recognition of collateral other than eligible collateral for defining the secured part of past due loans when applying SA. The exercise of this discretion is based on local market conditions.

1. **Overview of exercise:** The majority of Member States (87%) do not apply this option and only 13 % of the Members exercise it.

2. **Overview of responses:** The majority of Members ranked it as very important, important or fairly important (16 Members and 5 industry representatives) while 10 Members and 1 industry representative considered that this option has little importance or is not relevant for them. The main views expressed were to keep it in the present form (5 Members and 5 industry representatives); to remove the option (21 Members and 1 industry representative); to transform the option into a general rule (5 industry representatives). The great majority of Members do not recognise collateral other than eligible collateral for defining the secured part of past due loans and support the proposal to remove the option immediately or after the transition period. The industry wishes to keep it or transform it into a general rule.

3. **Main drivers:** Some Members expressed the view that this transitional provision will end automatically at the specified date, others indicated that

protection providers should meet the same eligibility criteria as for other aspects of the framework. According to industry answers, this treatment should be consistently applied to all EU institutions. This is an incentive for credit institutions to go for an advanced approach during the transitional period.

4. **Impact on business:** The majority of respondents from the membership and the industry have not indicated direct implications for their business.

5. **Possible solutions:** Given the short expiration date of this transitional national discretion it is proposed to **keep it in the present form till the end of the transition period**.

6. **Drafting proposal:** No change is necessary. The provision should be deleted at the end of its validity.

70. Transitional, Article 154.1 (Directive 2006/48/EC)

"Until 31 December 2011, the competent authorities of each Member State may, for the purposes of Annex VI, Part 1, point 61, set the number of days past due up to a figure of 180 for exposures indicated in Annex VI, Part 1, points 12 to 17 and 41 to 43, to counterparties situated in their territory, if local conditions make it appropriate. The specific number may differ across product lines."

Objective of the discretion: This national discretion temporarily allows the use of a more permissive definition of past due items when applying SA: Member States may set up to 180 days past due instead of 90 days. The exercise of this discretion is based on local market conditions.

1. **Overview of exercise:** The majority of Member States (77%) do not apply this option and 23% of the Members exercise it.

2. **Overview of responses:** 17 Members and 6 industry representatives classified the option as very important, important or fairly important, 9 Members and 1 industry representatives are of the opinion that it has little importance or relevance for them. The main views expressed were to keep it in the present form (8 Members and 4 industry representatives); or to remove the option completely (17 Members and 6 industry representatives).

3. **Main drivers:** Although some Members expressed the view that different definitions of the past due may give rise to distortions in the capital calculation, other respondents proposed to keep this option until the end of the transition period because it is extremely important for the banks in their jurisdictions. The majority of industry responses show their strong interest in keeping this option due to business specificities and legal procedures in certain countries.

4. **Impact on business:** The majority of respondents from the membership and the industry have not indicated direct implications for their business. A few

respondents mentioned that it can create a level playing field problem for institutions operating in the same market.

5. **Possible solutions:** The majority of Members do not apply this national discretion and are in favour of removing the option immediately or after the transition period; this opinion is shared by the majority of industry respondents, although others proposed to clarify that banks with subsidiaries in the countries with longer past due periods have a choice on whether to use for these subsidiaries the home or the local past due definition. Although it should be noted that this proposal goes against the application of the mutual recognition principle which was considered to be a possible tool for further solutions on convergence. Given the short time before its expiry, the proposal is **to keep the provision in its present form till the end of the transition period.**

6. **Drafting proposal:** No change is necessary. The provision should be deleted at the end of its validity.

71. Transitional, Article 154.2 (Directive 2006/48/EC)

"For credit institutions applying for the use of the IRB Approach before 2010, subject to the approval of the competent authorities, the three years' use requirement prescribed in Article 84(3) may be reduced to a period no shorter than one year until 31 December 2009."

Objective of the discretion: The provision allows for a temporary reduction of the 3 years use test to 1 year when applying for the use of the IRB approach.

1. **Overview of exercise:** 93 % of Member States apply this option, only 7 % do not apply it.

2. **Overview of responses:** 21 Members and 3 industry representatives classified the option as very important, important or fairly important (mostly as very important). 10 Members and 3 industry representatives would prefer to keep it in the present form; 8 Members to remove the option after the transition period and 6 Members and 6 industry representatives would like to transform the option into general rule. The majority of Members prefer to keep the provision in its present form till the expiry date or transform it into a general rule. The last proposal was supported by the industry which proposed to amend the CRD text by transforming the provision into a general rule or by keeping this transitional provision as an option for credit institutions.

3. **Main drivers:** This option is widely used by many Member States and is considered to be an important tool for the acceleration of the IRB implementation process. It is necessary to keep it for the banks which have adopted their internal rating systems relatively recently or are in the roll-out process of IRBA implementation.

4. **Impact on business:** The majority of respondents from the membership and the industry have not indicated direct implications for their business. A few Members indicated that exercise of this option could create level playing field problems if not applied consistently across the EU. For cross border groups it can mean different requirements in terms of the use test depending on the country.

5. **Possible solutions:** In CEBS's opinion this provision is not intended to be a national discretion, but a supervisory decision to be applied on a case by case basis with the aim of facilitating the IRB implementation process during the transition period for the banks which have recently established their internal ratings systems. This discretion should have been implemented by all Member States. The text of the Directive should be kept unchanged and the Member States that have not yet implemented this provision as a supervisory decision to be used on a case by case basis should be urged to do so as soon as possible. Given the very short time till the expiration of this provision and its transitional nature, it is deemed to be appropriate to **keep the supervisory decision in the present form till the end of the transitional period.** Because of the short time remaining CEBS does not advise implementing it as a supervisory decision in all Member States.

6. **Drafting proposal:** No change is necessary. The provision should be deleted at the end of its validity.

72. Transitional, Article 154.3 (Directive 2006/48/EC)

"For credit institutions applying for the use of own estimates of LGDs and/or conversion factors, the three year use requirement prescribed in Article 84(4) may be reduced to two years until 31 December 2008."

Objective of the discretion: Member States may temporarily allow institutions to reduce the 3 years requirement to 2 years when applying for the use of their own estimates of LGDs and/or conversion factors.

1. **Overview of exercise:** 93 % of Member States apply this option, while 7 % are not applying it.

2. **Overview of responses**: The majority of respondents (22 Members and 3 industry representatives) classified the option as very important, important or fairly important (mostly as very important). The main views expressed were to keep it in the present form (9 Members and 3 industry representatives); to remove the option after the transition period (8 Members); to transform the option into general rule (6 Members and 6 industry representatives). Both Members and industry prefer to keep this provision in the present form or to transform it into a general rule. Industry representatives proposed to change the wording of the CRD by transforming the option into a general rule or transforming it into an option for credit institutions.

3. **Main drivers:** This option is widely used by many Member States and is considered to be an important tool for the acceleration of the IRB implementation process.

4. **Impact on business:** A few Members indicated that exercise of this option could create level playing field problems. For cross border groups it can mean different requirements in terms of the use test depending on the country.

5. **Possible solutions:** In CEBS's view this provision is not intended to be a national discretion but a supervisory decision to be applied on a case by case basis in order to encourage banks to move towards more risk sensitive management systems during the transition period which ends in 2008. This discretion should have been implemented by all Member States. The text of the Directive should be kept unchanged and the Member States that have not yet implemented this provision as a supervisory decision to be used on a case by case basis should be urged to do so as soon as possible. In addition given the very short expiration date of this provision the proposal is to **keep the supervisory decision in the present form till the expiration date.** Because of the short time remaining CEBS does not advise implementing it as a supervisory decision in all Member States.

6. **Drafting proposal:** No change is necessary. The provision should be deleted at the end of its validity.

73. Transitional, Article 154.4 (Directive 2006/48/EC)

"Until 31 December 2012, the competent authorities of each Member State may allow credit institutions to continue to apply to participations of the type set out in Article 57(o) acquired before 20 July 2006 the treatment set out in Article 38 of Directive 2000/12/EC as that article stood prior to 1 January 2007."

Objective of the discretion: This national discretion temporarily allows exemption of certain types of participations from the Basel II framework and the continued application of Basel I treatment.

1. **Overview of exercise:** 60 % of Member States do not apply this option, 40% apply it.

2. **Overview of responses**: Majority of respondents (17 Members and 2 industry representatives) classified the option as very important, important or fairly important (mostly fairly important). 10 Members and 1 industry representative would prefer to keep it in its present form; 1 Member and 6 industry representatives would like to keep it as option for credit institutions; and 10 Members would prefer to remove the option (immediately or after the transition period). The majority of Members prefer to keep the national discretion in the present form or to remove it after the transition period, while industry is in the favour of transforming the national discretion into an option for credit institutions by amending the Directive text.

3. **Main drivers:** Respondents indicated a temporary nature for this option driven by market specificities. Industry representatives think that divergent application of this provision would penalise institutions subject to stricter requirements during the period allowed for adapting to Basel II requirements.

4. **Impact on business:** A few Members indicated that exercise of this option could create some cross border problems (due to the different treatment at solo and consolidated levels).

5. **Possible solutions:** When considering possible solutions CEBS took into account that this is a grandfathering provision temporarily allowing exemption from the Basel II framework only for those insurance undertakings which were acquired before the date specified. Given that, the proposal is **to keep this national discretion in the present form until the expiration date**.

6. **Drafting proposal:** No change is necessary. The provision should be deleted at the end of its validity.

74. Transitional, Article 154.6 (Directive 2006/48/EC)

"Until 31 December 2017, the competent authorities of the Member States may exempt from the IRB treatment certain equity exposures held by credit institutions and EU subsidiaries of credit institutions in that Member State at 31 December 2007".

Objective of the discretion: National discretion temporarily allows exemption from the IRB treatment of certain equity exposures held by credit institutions and EU subsidiaries of credit institutions in particular Member States.

1. **Overview of exercise:** 53 % of Member States apply this option and 47 % do not apply it.

2. **Overview of responses:** The majority of respondents (20 Members and 2 industry representatives) classified this option as very important, important or fairly important (mostly as fairly important). 11 Members would like to keep it in the present form; 13 Members would prefer to remove the option immediately or after the transition period; and 6 industry representatives would like to transform the option into a general rule and, preferably, to apply the option to all equity exposures by amending the Directive.

3. **Main drivers:** Some respondents indicated that a transitional period till the end of 2017 seems very long and it would be reasonable to establish earlier date for its expiration, although others were of the opinion that the option should be kept until the end of the transition period since there had been fundamental reasons for establishing it.

4. **Impact on business:** Unlevel playing field and cross border considerations were mentioned among the factors having an impact on business.

5. **Possible solutions:** Similarly to national discretion 73, this is a grandfathering provision which is currently effective only for certain equity

exposures held by the institutions at the end of 2007. Given that, the proposal is to **keep the national discretion in the present form till the expiration date**.

6. **Drafting proposal:** No change is necessary. The provision should be deleted at the end of its validity.

75. Transitional, Article 155 (Directive 2006/48/EC)

"Until 31 December 2012, for credit institutions the relevant indicator for the trading and sales business line of which represents at least 50 % of the total of the relevant indicators for all of its business lines accordance with Annex X, Part 2, points 1 to 4, Member States may apply a percentage of 15 % to the business line 'trading and sales'."

Objective of the discretion: National discretion which temporarily allows Member States to apply a preferential risk weight (15 % instead of 18 %) to the trading and sales business line when calculating TSA credit institutions capital requirement for operational risk if a certain condition is met.

1. **Overview of exercise:** 57 % of Member States do not apply this option, 43% apply it.

2. **Overview of responses:** The majority of respondents (16 Members and 2 industry representatives) classified the option as not important or not relevant for the respondent. 1 Member and 1 industry respondent ranked the option as very important for their business. 7 Members and 3 industry representatives would prefer to keep it in the present form; 18 Members and 2 industry representatives favoured removing the option immediately or after the transition period. Some industry representatives would prefer to amend the Directive by transforming the option into a general rule during the transitional period.

3. **Main drivers:** Some Members expressed their doubts regarding the reasonableness of this option, others were of the opinion that it should be kept in order to ensure a level playing field.

4. **Impact on business:** The majority of respondents did not indicate direct implications for their business.

5. **Possible solutions:** The provision has a limited scope of application and a low relevance for the majority of respondents, which points towards deletion. On the other hand it would have a negative impact on institutions that use it if it is deleted prior to the end of the term set. Therefore, it is proposed **to keep this national discretion in the present form until the end of the transitional period**, consistently with national discretion 78 applicable to investment firms.

6. **Drafting proposal:** No change is necessary. The provision should be deleted at the end of its validity.

76. Transitional, Annex VII, Part 2, Point 8 (second subparagraph) (Directive 2006/48/EC)

"Until 31 December 2010, covered bonds as defined in Annex VI, Part 1, points 68 to 70 may be assigned an LGD value of 11,25 % if (…)"

Objective of the discretion: National discretion which temporarily allows credit institutions to apply a reduced LGD value for covered bonds (11.25 % instead of 12.5 %) if certain conditions are met.

1. **Overview of exercise:** The majority of Member States (80%) apply this option, 20 % of the Member States do not exercise it.

2. **Overview of responses:** There are no clear preferences among Members regarding the importance of this option: 12 Members and 2 industry representatives are of the opinion that it has little importance or is not relevant for them, but 12 other Members and 4 industry representatives classified the option as very important, important or fairly important (mostly as fairly important). 15 Members and 6 industry representatives favour keeping it in the present form; 8 Members would prefer to remove the option immediately or after the transition period and 1 Members and 4 industry representatives would rather transform it into a general rule.

3. **Main drivers:** It was pointed out that it is a transitional provision and should be reviewed after its expiration.

4. **Impact on business:** The majority of respondents (Members and industry) have not indicated direct implications for their business.

5. **Possible solutions:** This is not an explicit national discretion to be exercised by Member States but is already an option for the credit institutions to assign a lower LGD value for covered bonds if certain conditions are met. Given this it would not make a sense to change the CRD wording by transforming the discretion into a general rule during the transition period as was proposed by industry. Since both the majority of Members and industry are willing to keep the provision in the present form the proposal is to **keep the option for credit institutions in the present form**.

   However, it should be noted that the CRD already contains a provision (Annex VII, Part 2, Para. 8 last subparagraph) on the obligatory review of this derogation prior to its expiry date on 31 December 2010. This should be reviewed prior to that date. Also, it should be noted that it is not so much a transitional provision for the implementation of the CRD as a transitional provision for the transfer to the IRB approach.

6. **Drafting proposal:** No change is necessary. Following the result of the review, the article should either be extended or alternatively deleted at the end of its validity.

77. Transitional, Annex VII, Part 4, Point 66, 71, 86 and 95 (Directive 2006/48/EC)

"66. Irrespective of whether a credit institution is using external, internal, or pooled data sources, or a combination of the three, for its PD estimation, the length of the underlying historical observation period used shall be at least five years for at least one source. If the available observation period spans a longer period for any source, and this data is relevant, this longer period shall be used. This point also applies to the PD/LGD Approach to equity. Member States may allow credit institutions which are not permitted to use own estimates of LGDs or conversion factors to have, when they implement the IRB Approach, relevant data covering a period of two years. The period to be covered shall increase by one year each year until relevant data cover a period of five years. (…)"

Objective of the discretion: A more permissive requirement for the minimum length of observation periods: Member States may in the transitional period allow a reduction in the minimum length of the observation periods required for own estimations of PD, LGD and CCF, subject to an absolute minimum of 2 years.

1. **Overview of exercise:** The great majority of Member States (97%) exercise this discretion; only 3 % of the countries do not apply it.

2. **Overview of responses:** 21 Members and 4 industry representatives classified this option as very important, important or fairly important (mostly as important), 5 Members and 1 industry representative are of the opinion that it has little importance or is not relevant for them. The main views expressed were to keep it in the present form (7 Members and 3 industry representatives); to remove the option after the transition period (7 Members); to transform option into a general rule (10 Members and 3 industry representatives). Industry representatives would also like to transform it into an option for credit institutions.

3. **Main drivers:** This option is widely used by many Member States in order to facilitate the transition of institutions from the standardised to the more risk sensitive IRB approach.

4. **Impact on business:** 9 Members indicated that eventually divergent exercise of the option may have an impact on their business.

5. **Possible solutions:** The national discretion is widely applied across Member States in order to encourage banks to move towards more risk sensitive approaches. In fact this is not a transitional provision in the sense that it applies to credit institutions when they implement the CRD no matter the year of implementation. However it seems to be applied, at least in a number of Member States, on a case by case basis. The proposal is to transform the **national discretion into a supervisory decision to be applied on a case by case basis** which allows the competent authority to assess the sufficiency of the data. It is noted that the provision only addresses the acceptable <u>length</u> of observations and not <u>data quality</u> issues which are raised in national discretion number 46.

6. **Drafting proposal:**

(…) <u>Subject to the approval of competent authorities,</u> credit institutions which are not permitted to use own estimates of LGDs or conversion factors, when they implement the IRB Approach, may use relevant data covering a minimum period of two years. The period to be covered shall increase by one year each year until the relevant data cover a period of five years. (…)

78. Transitional, Article 44 (Directive 2006/49/EC)

"Until 31 December 2012, for investment firms the relevant indicator for the trading and sales business line of which represents at least 50 % of the total of relevant indicators for all of their business lines calculated in accordance with Article 20 of this Directive and points 1 to 4 of Part 2 of Annex X to Directive 2006/48/EC, Member States may apply a percentage of 15 % to the business line 'trading and sales'."

Objective of the discretion: National discretion temporarily allows Member States to apply a preferential risk weight (15 % instead of 18 %) to the trading and sales business line when calculating TSA investment firms' capital requirement for operational risk if certain condition is met.

1. **Overview of exercise:** 47% of Member States exercise this option, 33 % do not apply it, while 20% did not clearly indicate.

2. **Overview of responses:** The majority of respondents (12 Members and 2 industry representatives) classified the option as not important or not relevant for the respondent. 1 Member and 2 industry respondents ranked the option as very important for their business. The main views expressed were to keep it in the present form (4 Members and 4 industry representatives); to keep it as an option for credit institutions (1 Member and 2 industry representatives); and 14 Members and 1 industry respondent expressed a clear preference to remove this option immediately or after the transitional period. Similarly to national discretion 75, some industry representatives proposed to amend the Directive by transforming the option into a general rule during the transitional period.

3. **Main drivers:** Some Members indicated that this option has little importance for them, while 1 Member is in the favour of keeping it until the end of the transition period due to fundamental reasons.

4. **Impact on business:** The majority of respondents did not indicate direct implications for their business.

5. **Possible solutions:** Given the limited scope of application of this national discretion and its low relevance to the majority of respondents, it is proposed **to keep the national discretion in the present form until the expiry date**, consistently with national discretion 75 applicable to credit institutions.

6. **Drafting proposal:** No change is necessary. The provision should be deleted at the end of its validity.

79. Transitional, Article 46 (Directive 2006/49/EC)

"By way of derogation from Article 20(1), until 31 December 2011 competent authorities may choose, on a case by case basis, not to apply the capital requirements arising from point (d) of Article 75 of Directive 2006/48/EC in respect of investment firms to which Article 20(2) and (3) do not apply, whose total trading book positions never exceed EUR 50 million and whose average number of relevant employees during the financial year does not exceed 100. (…)"

Objective of the discretion: More permissive alternative transitional operational risk requirement for small investment firms

1. **Overview of exercise:** 43% of Member States do not apply this option, 33% exercise it and 23% of the respondents did not indicate clearly.

2. **Overview of responses**: There are no clear preferences among respondents regarding the importance of this option. 12 Members and 2 industry representatives classified option as very important, important or fairly important, 10 Members and 2 industry representatives expressed the opinion that it is not important or not relevant for the respondent. 8 Members and 6 industry representatives would prefer to keep it in the present form; 11 Members and 2 industry representatives would rather remove it immediately or after the transition period; and 5 Members and 1 industry representative expressed no preference regarding the future treatment of this discretion. 1 of the industry representatives proposed to transform it into an EU-wide general rule in order to keep the principle of proportionality in place for small investment firms.

3. **Main drivers:** Many Members pointed out that this temporary option is not very relevant to their business except 1 for Member for which this option is very important and which wants it kept until the end of the transition period. Industry representatives also agreed that it is a temporary option reflecting business specificities.

4. **Impact on business:** No respondent indicated direct implications for their business.

5. **Possible solutions:** In CEBS's view this provision is not intended to be a national discretion, but a supervisory decision to be applied on a case by case basis that should have been implemented by all Member States. The aim of the discretion is to create more favourable conditions for small investment firms during the transition period. Considering the short expiration date of the transitional provision, its limited application and that it is a grandfathering provision, the proposal is **to keep the supervisory decision in the present form until the expiry date.** Because of the short time remaining CEBS does not advise implementing it as a supervisory decision in all Member States.

6. **Drafting proposal:** No change is necessary. The provision should be deleted at the end of its validity.

80. Transitional, Article 47 (Directive 2006/49/EC)

"Until 31 December 2009 or any earlier date specified by the competent authorities on a case by case basis, institutions that have received specific risk model recognition prior to 1 January 2007 in accordance with point 1 of Annex V may, for that existing recognition, treat points 4 and 8 of Annex V to Directive 93/6/EEC as those points stood prior to 1 January 2007."

Objective of the discretion: National discretion temporarily allows institutions to apply previously recognized specific market risk models.

1. **Overview of exercise:** 57% of Member States do not apply this option, 36% exercise it, 7% of the respondents did not indicate clearly.

2. **Overview of responses:** There are no clear preferences among the respondents regarding the importance of this option. 11 Members and 1 industry representative classified the option as very important, important or fairly important (mostly as very important), 14 Members and 3 industry representatives expressed the opinion that it is not important or not relevant for the respondent. The main views expressed were to keep it in the present form (10 Members and 4 industry representatives) and to remove the option after the transition period (6 Members and 2 industry representatives).

3. **Main drivers:** According to the views of Members this option is driven by market and business specificities. This transitional provision is necessary for the banks which need to adapt their existing VaR models to the new requirements and should be kept till the end of the transition period. Industry representatives also agreed that it is a temporary option reflecting business specificities.

4. **Impact on business:** The great majority of the respondents (Members and industry representatives) did not indicate direct implications for their business.

5. **Possible solutions:** In CEBS's opinion this provision is not intended to be a national discretion, but a supervisory decision to be applied on a case by case basis that should have been implemented by all Member States. It should also be applied as such. The text from the Directive should be kept unchanged and the Member States that have not yet implemented this provision as a supervisory decision to be used on a case by case basis should be urged to do so as soon as possible. Considering its very short expiration date and that it is a grandfathering provision the proposal is to **keep the supervisory decision in the present form till the expiry date**. Because of the short time remaining CEBS do not advise implementing it as a supervisory decision in all Member States.

6. **Drafting proposal:** No change is necessary. The provision should be deleted at the end of its validity.

Area: Trading book

81. Trading book, Article 18.2 and 3 (Directive 2006/49/EC)
18.2: "By way of derogation from paragraph 1, the competent authorities may allow institutions to calculate the capital requirements for their trading book business in accordance with Article 75(a) of Directive 2006/48/EC and points 6, 7, and 9 of Annex II to this Directive, where the size of the trading book business meets the following requirements: (…)
18.3: "In order to calculate the proportion that trading-book business bears to total business for the purposes of points (a) and (c) of paragraph 2, the competent authorities may refer either to the size of the combined on- and off-balance-sheet business, to the profit and loss account or to the own funds of the institutions in question, or to a combination of those measures. (…)"
Objective of the discretion: The Competent Authorities may allow institutions to apply banking book rules to their trading book exposures, provided the trading book activities do not exceed certain limits. This treatment doesn't correspond to a risk-sensitive one but avoids requiring small institutions to implement complex and burdensome approaches. Generally it is not a permissive treatment.

1. **Overview of exercise:** 96 % of Member States apply this option.

2. **Overview of responses:** 10 respondents favour keeping the option in its present form and 11 as an option for institutions (2/3 of the industry). 13 of the respondents want to transform it into general rules. Only one respondent (a Member) is in favour of completely removing the option from the CRD. Most Members regard the option as either very important or important. Although there were a limited number of answers to this question, most respondents mentioned "mutual recognition" as the best solution for this discretion.

3. **Main drivers**: The key drivers are apparently the fact that it would be unduly burdensome to require all institutions, notably those with very limited trading book activities, to apply the trading book rules. Another reason is local market conditions.

4. **Impact on business**: The limited number of the answers provided (but the number of answers on this issue is lower than the total number of answers) show that divergence on this option could be somewhat be problematic.

5. **Possible solution**: Like most of the trading book options, this is not a new option introduced by Basel 2; hence supervisors and industry have experience of its application. There is already a high degree of convergence (93% of Members exercise the discretion) and the apparent divergence between respondents willing to keep it in its present form or as an option for banks and respondents willing to transform the option into general rule is probably not so significant as the divergence seems to concern the process rather than the

final outcome. Proportionality is obviously a key driver here. The proposal is to **transform article 18.2 into an option for credit institutions**, based on the existing criteria. It is noted that this proposal may cause credit institutions to calculate capital requirements in a different manner, which could undermine the comparability between institutions. The tentative proposal is to **keep article 18.3 in its current form. CEBS invites respondents' views on this proposal**.

6. **Drafting proposal**: No change necessary in Article 18.3.

18.2. By way of derogation from paragraph 1, institutions may calculate the capital requirements for their trading book business in accordance (…).

82. Trading book, Article 19.2 (Directive 2006/49/EC)
"By way of derogation from points 13 and 14 of Annex I, Member States may set a specific risk requirement for any bonds falling within points 68 to 70 of Part 1 of Annex VI to Directive 2006/48/EC which shall be equal to the specific risk requirement for a qualifying item with the same residual maturity as such bonds and reduced in accordance with the percentages given in point 71 of Part 1 to Annex VI to that Directive." **Objective of the discretion**: Member States may set a reduced specific risk requirement for covered bonds booked in the trading book with reductions similar to those applied in the banking book under the standardised approach. It is a permissive treatment.

1. **Overview of exercise:** This option is exercised by 57% of the Member States.

2. **Overview of responses:** 17 respondents are in favour of keeping the option (either in the current form, subject to mutual recognition or as option for credit institutions). 12 respondents want to transform it into a general rule (half of industry responses), whereas 5 respondents wish to delete the option. Half of the answers stated that this option was, to them, either very important or important. In spite of the low number of responses received the solution indicated by most respondents is the application of mutual recognition.

3. **Main drivers**: One of the main drivers quoted is market specificities.

4. **Impact on business**: A limited number of the answers show that a divergence in the exercise of options and discretions by national authorities may have an impact on the business.

5. **Possible solution**: The views are split on this option. The differences observed might relate to a large extent to the different legal frameworks in place and the extent to which a covered bonds market exist (or is developed). Taking into account the feedback received from industry experts on the need to maintain this treatment CEBS considered proposing the **deletion of the discretionary part of the provision**, however this proposal can be difficult

to implement in practice since the CRD does not provide the "specific risk requirements" or the criteria to define them. An **alternative solution is to keep the national discretion in its current form**. **CEBS is seeking respondents' views on the costs and benefits of each of the possible solutions considered**.

6. **Drafting proposal**: No change, or, if the first proposal is opted for (i.e. deletion of the discretionary part of the national discretion):

> *"By way of derogation from points 13 and 14 of Annex I, Member States shall set a specific risk requirement for any bonds falling within points 68 to 70 of Part 1 of Annex VI to Directive 2006/48/EC which shall be equal to the specific risk requirement for a qualifying item with the same residual maturity as such bonds and reduced in accordance with the percentages given in point 71 of Part 1 to Annex VI to that Directive."*

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

"If, as set out in point 52 of Annex I, a competent authority approves a third country's collective investment undertaking (CIU) as eligible, a competent authority in another Member State may make use of this approval without conducting its own assessment."

Objective of the discretion: A Competent Authority of one Member State may make use of the approval of another one without conducting its own assessment. Eligible third country CIU can be treated with the specific approaches defined in the CRD for CIUs (more permissive than the default risk-weight).

1. **Overview of exercise:** This option is exercised by 66% of the Member States.

2. **Overview of responses:** The majority of the respondents want to keep the option, either in the present form or for supervisors or banks to decide (18 respondents) which shows the support for this option (only 2 respondents want to remove it completely). The industry clearly supports the mutual recognition principle (6 respondents). Half of the respondents rank this option as either very important or as important.

3. **Main drivers**: One of the main drivers quoted is "market specificities".

4. **Impact on business**: The majority of the answers show that a divergence in the exercise of options and discretions by national authorities may have an impact on the business.

5. **Possible solution**: In CEBS's view this provision **is not intended to be a national discretion, but a supervisory decision** to be applied on a case by case basis that should have been implemented by all Member States (the provision refers to 'competent authority' and not to Member States). It should also be applied as such. The text from the Directive could be kept unchanged

and the Member States that have not yet implemented this provision as a supervisory decision to be used in a case by case basis should be urged to do so as soon as possible. However, the possibility of **a joint assessment process** involving all supervisors that wish to participate (similar to the ECAI recognition process) should be considered. The outcome of the joint assessment process could be a public list of eligible third country CIUs that would form a strong common basis on which national competent authorities would form their decisions on the exercise of this supervisory decision. In addition a **non-binding mutual recognition clause** is proposed to promote convergence and also to alleviate the burden of the assessment.

6. **Drafting proposal**:

> *Annex I, point 52: Third country CIUs may be eligible if the requirements in points (a) and (e) of point 51 are met, <u>subject to the approval process defined in article 19.3.</u>*
>
> *Article 19.3: <u>When the eligibility of a third country CIU needs to be approved, the institution's competent authority shall invite all relevant competent authorities in the EU to participate in a joint assessment. When, as a result of a joint assessment, a competent authority of one Member State subsequently approves a third country's collective investment undertaking (CIU) as eligible, competent authorities of another Member State may use this approval without conducting their own assessment</u>.*

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

"Where the waiver provided for in Article 22 is not exercised, the competent authorities may, for the purpose of calculating the capital requirements set out in Annexes I and V and the exposures to clients set out in Articles 28 to 32 and Annex VI on a consolidated basis, permit positions in the trading book of one institution to offset positions in the trading book of another institution according to the rules set out in Articles 28 to 32 Annexes I, V and VI. (…)"

Objective of the discretion: For the purposes of calculation of consolidated capital requirements, competent authorities may authorise the offsetting of trading (trading book, commodities, etc.) positions even when they are booked in different institutions within the group, subject to certain conditions. This national discretion allows a permissive treatment, but its impact largely depends on the specific characteristics of institutions' portfolios.

1. **Overview of exercise:** This option is exercised by 67% of the Member States.

2. **Overview of responses:** Among the respondents, 8 are in favour of keeping the option in its present form and 8 would rather keep it as an option for credit institutions. Supervisors want to keep it in the present form or to be able to apply this option on a case by case basis, whereas the industry clearly wants this option to be transformed into an option for credit institutions. 10 of the respondents (only Members) are in favour of transforming it into a general rule. 4 respondents prefer deleting the option. Half of the answers rank this

option as either very important or important. In spite of the low number of responses to the question the solutions more often proposed by respondents are the application of mutual recognition and transforming the option into a general rule.

3. **Main drivers**: One of the main drivers refers to market specificities.

4. **Impact on business**: The majority of the answers show that a divergence in the exercise of options and discretions by national authorities may have an impact on the business.

5. **Possible solution**: Since this discretion corresponds to an old provision and a more permissive treatment deleting the provision has be considered. However since it relates to some extent to the principles of consolidated supervision and the scope of application its deletion could have a high impact and bring more costs than benefits. In any case in CEBS's view this provision **is not intended to be a national discretion, but a supervisory decision** to be applied on a case by case basis that should have been implemented by all Member States (the provision says "the competent authority may authorize" and not the Member States). It should also be applied as such. The text from the Directive should be kept unchanged and the Member States that have not yet implemented this provision as a supervisory decision to be used on a case by case basis should be urged to do so as soon as possible. It should be noted that some Member States expressed their concerns on the implementation of this supervisory decision in their jurisdictions since they believe the discretion should not be exercised in any circumstance.

6. **Drafting proposal**: No change necessary at the CRD level, but the provision should be implemented as a supervisory decision at the national level.

85. Trading book, Article 33.3 (Directive 2006/49/EC)

"In the absence of readily available market prices, the competent authorities may waive the requirement imposed in paragraphs 1 and 2 and shall require institutions to use alternative methods of valuation provided that those methods are sufficiently prudent and have been approved by competent authorities."

Objective of the discretion: The Competent Authorities, in the absence of readily available market prices, may choose not to apply daily mark to market and, instead, require institutions to apply alternative methods subject to their approval. This discretion aims at defining a prudent valuation mechanism in the absence of market prices. It is neither a permissive option nor a restrictive one.

1. **Overview of exercise:** This option is exercised by 80% of the Member States.

2. **Overview of responses:** The views are split, 12 respondents wants to keep the option in its present form and 4 would rather keep it as an option for credit institutions; 13 respondents support the idea of transforming it into a

general rule. 13 respondents regard this option as either very important or important.

3. **Main drivers**: The criterion “market specificities” is one of the most frequently mentioned criteria among the answers, which are not numerous enough to provide a reliable statistical analysis.

4. **Impact on business**: The vast majority of the answers show that a divergence in the exercise of options and discretions by national authorities may have an impact on the business.

5. **Possible solution**: The requirements for valuation and mark-to-model that were introduced in the Annex VII of Directive 2006/49/EC as a result of the trading book review (Basel 2.5) duplicate this old national discretion and are even more specific. It is thus proposed to **delete the provision** which doesn’t seem to be necessary any more.

6. **Drafting proposal**: Deletion of article 33.3 of Directive 2006/49.

86. Trading book, Annex I, Point. 4, 2nd paragraph (first sentence) (Directive 2006/49/EC)

“The competent authorities may allow the capital requirement for an exchange-traded future to be equal to the margin required by the exchange if they are fully satisfied that it provides an accurate measure of the risk associated with the future and that it is at least equal to the capital requirement for a future that would result from a calculation made using the method set out in this Annex or applying the internal models method described in Annex V.”

Objective of the discretion: Subject to certain conditions, the Competent Authorities may allow a permissive treatment of exchange-traded futures, i.e. the capital requirement would be equal to the margin required by the exchange.

1. **Overview of exercise:** 57% of the Member States do not apply this option.

2. **Overview of responses:** 7 respondents favour keeping the option in its present form; 9 respondents would prefer to keep it as an option for credit institutions (this response is mostly driven by the industry). 10 respondents would rather delete the provision completely. For 11 respondents this option is “fairly important” and 10 are “indifferent”.

3. **Main drivers**: The “market specificities” criterion is one of the most frequently mentioned by institutions in their answers which are somewhat heterogeneous, and relatively rare given the total number of answers to the questionnaire.

4. **Impact on business**: The majority of the answers show that a divergence in the exercise of options and discretions by national authorities may have an impact on the business.

5. **Possible solution**: This national discretion should be analysed in conjunction with discretions 87, 89, 90, 98 and 100. The key issue is whether reliance may be placed on margining requirements as an indicator for capital requirements. Supervisors tend to question the value of margining requirements as a proxy for capital requirements, given in particular the lack of transparency regarding the calculation of margining done by some entities but also due to the diversity of calculations from one entity to the other. For these reasons, it is proposed to **delete the provision**, **unless strong evidence is provided by respondents that margining requirements are an appropriate measurement.**

6. **Drafting proposal**: Deletion of Annex I, Point 4, 2nd paragraph (first sentence) of Directive 2006/49/EC.

87. Trading book, Annex I, Point 4, 2nd paragraph (second sentence) (Directive 2006/49/EC)

"The competent authorities may also allow the capital requirement for an OTC derivatives contract of the type referred to in this point cleared by a clearing house recognised by them to be equal to the margin required by the clearing house if they are fully satisfied that it provides an accurate measure of the risk associated with the derivatives contract and that it is at least equal to the capital requirement for the contract in question that would result from a calculation made using the method set out in the this Annex or applying the internal models method described in Annex V."

Objective of the discretion: Subject to certain conditions, the Competent Authorities may allow a more permissive treatment for OTC derivatives cleared by a clearing house, i.e. the capital requirement would be equal to the margin required by the clearing house.

1. **Overview of exercise:** 37% of Member States exercise the discretion (7% with a proviso); 60% do not exercise it.

2. **Overview of responses:** The answers are very diversified and distributed among all the proposals (7 respondents have no preference). 8 respondents prefer to keep the option in the present form; 6 respondents favour giving it as an option to credit institutions. 10 respondents (only Members) are in favour of deleting the option, either immediately or after a transitional period. The industry rather supports its transformation into an option for institutions. 5 respondents consider this option to be important and 11 respondents ranked it as fairly important.

3. **Main drivers**: The criterion market specificities is one of the most frequent criteria mentioned in the answers, these are very heterogeneous, and to some extent quite rare given the total number of answers to this question. The majority of the answers show that a divergence in the exercise of options and discretions by national authorities may have an impact on the business. The most widely proposed answer refers to the mutual recognition criterion, but there were few answers to this particular question.

4. **Impact on business**: Like the option in the first sentence of this subparagraph dealing with capital requirements for an exchange traded future, this option depends a lot upon the market conditions and the nature of the clearing house and the rules defined by it.

5. **Possible solution**: This national discretion should be analysed in conjunction with discretions 86, 89, 90, 98 and 100. **See discretion number 86.**

6. **Drafting proposal**: Deletion of Annex I, Point 4, 2nd paragraph (second sentence) of Directive 2006/49/EC.

88. Trading book, Annex I, point 5, 2nd paragraph (Directive 2006/49/EC)

"However, the competent authorities may also prescribe that institutions calculate their deltas using a methodology specified by the competent authorities."

Objective of the national discretion: Possibility for competent authorities to prescribe the methodologies for the calculation of delta for credit institutions. This discretion, when applied, allows more restrictive treatment of the delta calculation.

1. **Overview of exercise:** 40% of Member States have applied this discretion; 60% have not.

2. **Overview of responses:** 7 Members and 1 industry respondent wish to keep this national discretion in its present form; 2 Members would prefer to transform it into a general rule; 9 Members and 7 industry respondents would like to remove it completely from the CRD; and 11 respondents have no preference in respect of this discretion. For 7 respondents the discretion is very important or important; for 10 respondents it is fairly important and for 12 respondents is of no importance.

3. **Main drivers**: Competent authorities that have been applying this national discretion for a long period of time want to continue the existing policy. Reasons why the respondents want to remove the discretion from the CRD are as follows: an administrative burden on supervisors, a level playing field, to avoid fragmentation of the market and competitive distortions by removing the discretion, and a possibility to challenge institutions' models under the SREP.

4. **Impact on business**: A few supervisors and most industry respondents, particularly from the cross- border group, consider that the exercising of this discretion would result in an adverse impact on their business.

5. **Possible solution**: On the one hand exercising the discretion could place an administrative burden on supervisors and distortion of competition between institutions and on the other hand, as far as CEBS is aware, the deletion would not have a high impact. The proposal is therefore to **delete the provision completely.** The competent authorities that have specified a

methodology for the calculation of institutions' deltas consider it necessary may draw up guidelines for applying this methodology.

6. **Drafting proposal**: Deletion of Annex 1, point 5, 2nd paragraph, Directive 2006/49/EC.

89. Trading book, Annex I, point 5, 3rd paragraph, first and second sentence (Directive 2006/49/EC)

"(…) The competent authorities may allow the requirement against a written exchange-traded option to be equal to the margin required by the 30.6.2006 EN Official Journal of the European Union L 177/219 exchange if they are fully satisfied that (…) The competent authorities may also allow the capital requirement for an OTC option cleared by a clearing house recognised by them to be equal to the margin required by the clearing house if they are fully satisfied (…)".

.**Objective of the discretion:** The objective of the discretion, when applied, is to allow institutions to use the alternative capital requirements calculation for options. It allows implementation of a proportionate approach to the calculation of credit risk capital requirements for different institutions. This discretion, when applied, allows more permissive treatment in the capital requirement calculation which is proportionate to size and sophistication of the institution

1. **Overview of exercise:** 37% of the Member States have applied this discretion; 63% have not.

2. **Overview of responses:** 9 Members and 1 industry respondents wish to keep this national discretion in its present form; 2 Members and 1 respondent from the industry prefer to transform it into a general rule; 3 Members and 5 industry respondents favour giving the option to credit institutions; 9 Members favour removing it completely from the CRD; and 7 respondents have no preference in respect of this discretion. The discretion is important for 5 respondents; fairly important for another 11 and indifferent or irrelevant to 14 respondents.

3. **Main drivers**: Competent authorities that have been applying this national discretion for a long period of time want to continue with their existing policy. Reasons why the respondents want to leave the discretion in the CRD are as follows: it allows use of a simple method for calculation of capital requirements for less sophisticated or specialised institutions (acting as a dealer or market maker on a regulated market), as well as the possibility of applying this approach for a specific type of product.

4. **Impact on business**: All respondents assume that divergent exercise of the discretion would have no or a limited impact on the business.

5. **Possible solution**: This national discretion should be analysed in conjunction with discretions 86, 87, 90, 98 and 100. **See discretion number 86.**

6. **Drafting proposal**: Deletion of Annex I, point 5, 3rd paragraph, first and second sentence of Directive 2006/49/EC.

90. Trading book, Annex I, point 5, 3rd paragraph, last sentence (Directive 2006/49/EC)

"In addition they may allow the requirement on a bought exchange-traded or OTC option to be the same as that for the instrument underlying it, subject to the constraint that the resulting requirement does not exceed the market value of the option. The requirement against a written OTC option shall be set in relation to the instrument underlying it."

Objective of the discretion: The objective of the discretion, when applied, is to allow institutions to use the alternative capital requirements calculation for options. It allows implementation of a proportionate approach to the calculation of credit risk capital requirements for different institutions. This discretion, when applied, allows more permissive treatment in the capital requirement calculation which is proportionate to the size and sophistication of the institution.

1. **Overview of exercise:** 50% of the Member States have applied this discretion (of which 7% with a proviso).

2. **Overview of responses:** 9 Members and 1 respondent from industry wish to keep this national discretion in its present form; 2 Members and 5 of industry's respondents prefer to give the option to credit institutions; 9 Members would like to remove it completely from the CRD; 2 Members and 5 industry respondents would like to transform it into a general rule; and 7 respondents have no preference in respect of this discretion. The discretion is very important or important for 4 respondents; fairly important for another 12 and 14 respondents are indifferent or find it irrelevant.

3. **Main drivers**: Competent authorities that have been applying this national discretion for a long period of time want to continue their existing policy. Reasons why the respondents want to leave the discretion in the CRD are as follows: it allows use of a simple method for the calculation of capital requirements for less sophisticated or specialised institutions (acting as a dealer or market maker on a regulated market), as well as a possibility of applying this approach for a specific type of product.

4. **Impact on business**: All respondents assume that divergent exercise of the discretion would have no or a limited impact on the business.

5. **Possible solution**: This national discretion should be analysed in conjunction with discretions 86, 87, 89, 98 and 100. **See discretion number 86.**

6. **Drafting proposal**: Deletion of Annex 1, point 5.3 (2) of Directive 2006/49/EC.

91. Trading book, Annex I, point 14, next to last paragraph (Directive 2006/49/EC)

"Instruments issued by a non-qualifying issuer shall receive a specific risk capital charge of 8% or 12 % according to Table 1. Competent authorities may require institutions to apply a higher specific risk charge to such instruments and/or to disallow offsetting for the purposes of defining the extent of general market risk between such instruments and any other debt instruments."

Objective of the discretion: This provision provides the possibility for competent authorities to require a higher specific risk capital charge for a non-qualifying issuer.

1. **Overview of exercise:** 40% of the Member States have applied this discretion; 60% have not.

2. **Overview of responses:** 9 Members and 2 industry respondents wish to keep this national discretion in its present form; 4 Members would prefer to decide on a case by case basis; 7 Members and 7 respondents from the industry favour removing it completely from the CRD; 5 Members would rather transform it into a general rule; and 6 respondents have no preference in respect of this discretion. The discretion is very important or important for 7 respondents and fairly important for 11 respondents; 13 respondents find it irrelevant or are indifferent to it .

3. **Main drivers**: The reasons why the respondents want to remove the discretion from the CRD are as follows: divergence in the application of this discretion leads to distortions in the level playing field.

4. **Impact on business**: Most of respondents assume that divergent exercise of the discretion would have no or only a limited impact on the business, but two Members point out that their business will be impacted in this case.

5. **Possible solution**: Instruments issued by a non-qualifying issuer shall receive the same specific risk capital charge as an unrated corporate client under the standardised approach for credit risk. However, this may be the case when the specific risk is higher for debt instruments, which have a high yield to redemption compared to government debt securities. Institutions shall assess the underestimated specific risk of such debt instruments and apply a higher specific risk charge to such instruments and/or not apply offsetting to these debt instruments and other debt instruments for the purpose of the measurement of general market risk. The proposal **is to delete the discretionary part of the provision**. However, supervisors may always challenge the specific risk charges applied by firms in the context of their on-going supervision.

6. **Drafting proposal**: To redraft the next to last subparagraph of the article (i.e. the second after the table) as follows:

Institutions shall apply a specific risk capital charge of 8 % or 12% for instruments issued by a non-qualifying issuer according to Table 1. However, an institution shall apply a higher specific risk charge to such instruments and/or shall not use offsetting for the purposes of defining the extent of *general market risk between such instruments and any other debt instruments to the extent that doing otherwise would not be a prudent treatment of the specific risk or general market risk.*

92. Trading book, Annex I, point 26 (Directive 2006/49/EC)

"The competent authorities may allow institutions in general or on an individual basis to use a system for calculating the capital requirement for the general risk on traded debt instruments which reflect duration, instead of the system set out in points 17 to 25, provided that the institution does so on a consistent basis."

Objective of the discretion: Use of duration instead of the standard system for the calculation of the general risk of traded debt positions. The national discretion allows the possibility for credit institutions to apply a more advanced modelling approach

1. **Overview of exercise:** All Member States have applied this discretion.

2. **Overview of responses:** 9 Members and 2 industry respondents wish to keep this national discretion in its present form; 3 Members would prefer to decide on a case by case basis; 11 Members and 6 respondents from the industry propose giving it to credit institutions; 8 Members would rather transform it into a general rule; and 1 respondents has no preference in respect of this discretion. The discretion is very important or important for 16 Members and 1 industry respondent fairly important for 7 Members; and 7 respondents find it irrelevant or are indifferent to it.

3. **Main drivers**: It seems that respondents wish to keep the discretion as an option for credit institutions.

4. **Impact on business**: All respondents assume that there would be no or a limited impact on the business.

5. **Possible solution**: This discretion is in CEBS's view a supervisory decision to be applied on case by case basis. This provision should have been implemented as such by all Member States. However since the exercise of the discretion entails the application of an advanced and more risk-sensitive approach, there are clear benefits in transforming this supervisory decision **into an option for institutions.**

6. **Drafting proposal**:

Institutions may use a system for calculating the capital requirement for the general risk on traded debt instruments which reflects duration, instead of the system set out in Point 17 to 25, provided that the institution does so on a consistent basis.

93. Trading book, Annex I, point 35, 1st paragraph (Directive 2006/49/EC)

"By derogation from point 34, the competent authorities may allow the capital requirement against specific risk to be 2 % rather than 4 % for those portfolios of equities that an institution holds which meet the following conditions: (…)"

Objective of the discretion: Possibility for competent authorities to reduce the specific risk capital charge for certain equity portfolios. This discretion, when applied, allows a more permissive treatment.

1. **Overview of exercise:** 80% of Member States have applied this discretion; 20% have not.

2. **Overview of responses:** 9 Members and 2 industry respondents wish to keep this national discretion in its present form; 2 Members would prefer to decide on a case by case basis; 3 Members favour removing it completely from the CRD; 12 Members and 7 industry respondents would rather transform it into a general rule; and 4 respondents have no preference in respect of this discretion. The discretion is very important or important for 12 respondents and fairly important for 8 respondents; 9 respondents find it irrelevant or are indifferent to it.

3. **Main drivers**: Reasons why the respondents want to leave the discretion in the CRD are as follows: the discretion is prudentially reasonable where the applicable criteria are met. This discretion allows for the possibility of differentiating the specific risk requirement in equity portfolios that comply with the conditions laid out in the directive, namely that the equities must be of credit quality step 1 or 2, no position shall be more than 5% of the portfolio (diversification) and the competent authority has deemed that the equities are highly liquid. The difference in weighting should therefore be seen as an appropriate differentiation between a highly rated, diversified and liquid portfolio versus a portfolio that is not in compliance with these limits. Rather than describing this treatment as permissive, it is more accurate to say that it is consistent with the CRD approach to risk sensitivity and should be seen as a rule that encourages institutions to hold better quality and diversified portfolios.

4. **Impact on business**: Most of respondents assume that there would be no or a limited impact on the business resulting from divergent exercise of the discretion.

5. **Possible solution**: This discretion is in CEBS's view **not intended to be a national discretion, but a supervisory decision to be applied on a case by case basis**. This provision should have been implemented as such by all Member States. It should also be applied as such. The text from the Directive could be kept unchanged and the Member States that have not yet implemented this provision as a supervisory decision to be used in a case by case basis should be urged to do so as soon as possible. Since a large majority of Member States have chosen to apply the discretion and the criteria are defined, CEBS has considered to **transform it into an option for credit institutions**, but there are some concerns about the subjective nature of the criteria and therefore more objective criteria should be developed before that solution could be considered.

6. **Drafting proposal**: **If feedback results in the identification of workable objective criteria**, then this could become an option for credit institutions:

35. By derogation from point 34, <u>institutions may</u> apply 2% rather than 4% for calculation of the capital requirement against specific risk for those portfolios of equities that an institution holds which meet the following conditions: *(a) the equities shall not be those of issuers which have issued only traded debt instruments that currently attract an 8 % or 12 % requirement in Table 1 to point 14 or that attract a lower requirement only because they are guaranteed or secured;* *(b) the equities must be adjudged highly liquid by the competent authorities according to objective criteria; and* *(c) no individual position shall comprise more than 5 % of the value of the institution's whole equity portfolio.* *[(d) … additional criteria to be identified…]*

If, on the other hand, no additional criteria emerge, then no change is necessary at the CRD level, but the provision should be implemented as a supervisory decision at the national level.

94. Trading book, Annex I, point 35, 2nd paragraph (Directive 2006/49/EC)

"For the purpose of point (c), the competent authorities may authorise individual positions of up to 10% provided that the total of such positions does not exceed 50% of the portfolio."

Objective of the discretion: Possibility for Member States' supervisors to set alternative criteria for an individual position included in an institution's equity portfolio with a reduced risk weight. This discretion, when applied, allows more permissive treatment.

1. **Overview of exercise:** 70% of the Member States have applied this discretion.

2. **Overview of responses:** 8 Members and 2 of industry's respondents wish to keep this national discretion in its present form; 10 of the Members and 7 industry respondents would prefer to transform it into a general rule; 1 Members would like to remove it completely from the CRD and 7 respondents have no preference in respect of this discretion. For 72% of respondents the discretion is perceived as at least important. The discretion is very important or important for 8 respondents and fairly important for 13 respondents; 8 respondents find it irrelevant or are indifferent to it.

3. **Main drivers**: Reasons why the respondents want to leave the discretion in the CRD are as follows: the discretion is prudentially reasonable; this alternative also imposes an adequate granularity requirement; proportionality for smaller institutions; specific risks in well-diversified portfolios are low. This discretion allows for an extension of the diversification limit whereby competent authorities may allow a single name to make up 10% of the

portfolio (subject to a limit of 50% of the entire portfolio, i.e. 5 names at 10% each).

4. **Impact on business**: Most of respondents assume there would be no or only a limited impact on the business resulting from divergent exercising of the discretion, but some respondents have recognised the impact on institutions with significant equities portfolios and on cross-border groups in terms of administrative and capital burden.

5. **Possible solution**: This discretion can be exercised only if the provision in the discretion number 93 has been exercised and the analysis is dependent upon the decision regarding discretion 93. In CEBS's view this provision is not intended to be a national discretion, but a supervisory decision to be applied on a case by case basis because applying it allows changes in the criteria for the equity portfolio structure. This provision should have been implemented as such by all Member States. However, since the discretion allows supervisors to take into account the proportionality of business and diversification of the portfolio the cost/benefit analysis indicates that the proposal should be to **delete the discretionary part of the provision**.

6. **Drafting proposal**: Deletion of Annex I, point 35, last sentence (discretion) of Directive 2006/49/EC and rewording Point 35(c) as follows:

no individual position exceeds 10 % of the portfolio's gross value. The sum of positions which individually represent between 5 % and 10 % of the portfolio's gross value does not exceed 50 % of the portfolio's gross value.

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

"The competent authorities shall have the discretion to allow institutions to use the net present value when calculating the net open position in each currency and in gold."

Objective of the discretion: The competent authorities have the discretion to allow institutions to use net present value when determining their open positions in currencies or gold. The provision allows an alternative method for the valuation of positions.

1. **Overview of exercise:** 80% of Member States has implemented this provision.

2. **Overview of responses:** In line with the fairly clear exercise rate, there is a clear majority in favour of keeping this national discretion (7 respondents in the present form and 17 as an option for credit institutions. There are only 2 respondents that prefer a complete removal of the option from the CRD; they do not see this issue as very important or important. The discretion is very important or important for 10 respondents and fairly important for 13 respondents; 8 respondents find it irrelevant or are indifferent to it.

3. **Main drivers**: When responses that are rooted in local conditions are discounted, one common theme emerges from industry responses which is also mirrored by some supervisors. These respondents state that the provision penalises institutions that are subject to stricter requirements, therefore it should be available as an option for credit institutions.

4. **Impact on business**: The option is assigned average importance overall.

5. **Possible solution**: In CEBS's opinion this provision **is not intended to be a national discretion, but a supervisory decision** to be applied on a case by case basis that should have been implemented by all Member States. It should also be applied as such. The text from the Directive could be kept unchanged and the Member States that have not yet implemented this provision as a supervisory decision to be used in a case by case basis should be urged to do so as soon as possible. However transforming this national discretion into an **option for credit institutions** may also be a way forward. This would be only a gradual deviation from the position of nearly all respondents that had not chosen this treatment as they were contemplating keeping this treatment in some form anyway. **Input is welcomed on the choice between these two solutions.**

6. **Drafting proposal**: Either no change necessary at the CRD level, but the provision should be implemented as a supervisory decision at the national level; or, if this is transformed into an option for credit institutions:

Institutions may use net present value when calculating the net open positions in each currency and in gold provided that the institution makes this choice consistently.

96. Trading book, Annex III, point 3.1 (Directive 2006/49/EC)
"The competent authorities may allow institutions to provide lower capital requirements against positions in closely correlated currencies than those which would result from applying points 1 and 2 to them. The competent authorities may deem a pair of currencies to be closely correlated only if (…) "   **Objective of the discretion**: The provision provides an alternative calculation method that is more permissive.

1. **Overview of exercise:** 57% of Member States have implemented this discretion; 43% have not.

2. **Overview of responses:** As a result it is not surprising to see fairly dispersed responses. 7 Members wish to remove the option from the CRD immediately or after a transition period and for these Members it is not a critical issue (one fairly important, one indifferent). Industry uniformly calls for this provision to be turned into an option for banks. It could be argued that those respondents that call for its transformation into a general rule and removal of the other option, most likely not to want Nos 1 and 2 of Annex 3 to be removed so that there is a good number of respondents who wish to make this calculation method available. 2 respondents believe that either the calculation method in

Nos 1 and 2 of Annex 3 or VaR should be used and that there is no need for a third calculation method. 1 respondent (and this appears to be shared by industry) argues that the calculation method should be made available to banks if they wish to undertake the necessary work.

3. **Main drivers**: Industry uniformly argues that the "definition of close correlation is set out in the Directive and can be challenged by the competent authority - but where the correlation is acknowledged, lower capital requirements should be allowed as a rule".

4. **Impact on business**: Only a quarter of respondents rate this discretion as very important or important, none of them are from the industry. Overall the provision is assigned below average importance.

5. **Possible solution**: In CEBS's view this provision is not intended to be a national discretion, but a supervisory decision to be applied on a case by case basis that should have been implemented as such by all Member States. In one hand the provision applies in particular to Member Sates where the currency (other than the Euro) is closely related with the Euro and consequently with each other. On the other hand the provision seems to have lost its relevance in the Members States where the Euro has been introduced. **CEBS is therefore seeking for respondents' views on the need to keep this provision as a supervisory decision on a case by case basis. If no such input is received CEBS's proposal will be to delete the provision from the CRD.**

6. **Drafting proposal**: Either no change is necessary at the CRD level, but the provision should be implemented as a supervisory decision at the national level; or, if no feedback is received, delete Annex III, point 3.1 of Directive 2006/49/EC.

97. Trading book, Annex IV, point 7 (Directive 2006/49/EC)

"The competent authorities may regard the following positions as positions in the same commodity:

(a) positions in different sub-categories in cases where the sub-categories are deliverable against each other; and

(b) positions in similar commodities if they are close substitutes and if a minimum correlation of 0,9 between price movements can be clearly established over a minimum period of one year."

Objective of the discretion: This provision extends position netting in some cases, different but closely linked commodities treated the same, for the purposes of calculating the position in a commodity – permissive.

1. **Overview of exercise:** 80% of Member States have implemented this provision (of which 3% with a proviso).

2. **Overview of responses:** A clear majority of respondents wishes to keep this provision either in its present form or as a general rule or an option for credit institutions. 4 respondents call for the removal of the provision from the CRD, with none seeing this as a critical issue and with one of them indicating that there is little experience with commodities in its jurisdiction (this is echoed by others).

3. **Main drivers**: The industry respondents uniformly call for a general rule to achieve consistent treatment and avoid competitive distortions. They add that the supervisor may still decide that a bank's judgment that positions are closely linked is wrong. The issue of level playing field/convergence is also picked up by a number of Members.

4. **Impact on business**: This provision is seen as having average importance.

5. **Possible solution**: In CEBS's view this provision is not intended to be a national discretion, but a supervisory decision to be applied on a case by case basis. A choice will need to be made between keeping this provision or transforming it into a general rule (keeping it as a choice for banks is regarded as a subset of the latter, as banks will in any event be free not to regard closely linked commodities as the same). This substantially leaves only the question whether supervisors want to be involved before this provision is applied or not. This is deemed not to be the case, so the proposal is to **delete the discretionary part of the provision.**

6. **Drafting proposal**:

For the purposes of calculating a position in a commodity, the following positions shall be regarded as positions in the same commodity:"

[criteria a and b remain the same as currently in the directive].

98. Trading book, Annex IV, point 8 (Directive 2006/49/EC)

"The competent authorities may allow the capital requirement for an exchange-traded future to be equal to the margin required by the exchange if they are fully satisfied that (…). The competent authorities may also allow the capital requirement for an OTC commodity derivatives contract of the type referred to in this point cleared by a clearing house recognised by them to be equal to the margin required by the clearing house if (…) "

Objective of the discretion: The objective of the discretion, when applied, is to allow institutions to use an alternative capital requirements calculation. This discretion, when applied, allows more permissive treatment in the capital requirement calculation.

1. **Overview of exercise:** 36% of Member States have implemented this provision (of which 3% with a proviso); 64% have not.

2. **Overview of responses:** However, nearly half of all respondents (including industry) wish to retain the provision in one form or another. On the other

hand, 9 Members want a removal of the provision, with none of them rating the issue important or very important.

3. **Main drivers**: The key issue is whether reliance may be placed on margining requirements as an indicator for capital requirements. While three supervisors consider this provision a useful and adequate shortcut, one supervisor questions the value of margining requirements, citing in particular that clearing houses do not provide transparency as regards their calculations. The industry cites convergence and a level playing field as key drivers of its call to transform the provision into an option for credit institutions.

4. **Impact on business**: This provision is assigned low average importance and importantly, a number of jurisdictions indicate that there is little experience with the provision or little relevant business or both.

5. **Possible solution**: This national discretion should be analysed in conjunction with discretions 86, 87, 89, 90 and 100. **See discretion number 86.**

6. **Drafting proposal:** Deletion of Annex 4, point 8, Directive 2006/49/EC.

99. Trading book, Annex IV, point 10, 2nd paragraph (Directive 2006/49/EC)

"However, the competent authorities may also prescribe that institutions calculate their deltas using a methodology specified by the competent authorities."

Objective of the discretion: Possibility for competent authorities to prescribe the methodologies for the calculation of delta for credit institutions. This discretion, when applied, allows more restrictive treatment of the delta calculation

1. **Overview of exercise:** 37% of Member States have implemented the provision (7% with a proviso), 63% have not implemented it.

2. **Overview of responses:** 8 Members and 1 industry respondents wish to keep this national discretion in its present form; 4 Members would prefer to decide on a case by case basis; 10 Members and 7 industry respondents favour removing it completely from the CRD; and 8 respondents have no preference in respect of this discretion. The discretion is very important or important for 5 respondents and fairly important for 11 respondents; 14 respondents find it irrelevant or are indifferent to it.

3. **Main drivers**: Even though there is significant dispersion in the results, a review of the reasons provided by respondents show two important parallel strands of reasoning. The industry argues that supervisors may challenge models in the SREP and that prescribing deltas on top of that would be excessive. A number of regulators point to commercial sources that provide delta calculations and others reinforce this message by saying that it is not the task of supervisors to engage in this calculation at all. From these, a common theme emerges: it is the obligation of the institution to calculate the

delta; it can obtain help with this calculation and supervisors do not want to take over the institutions' responsibility.

4. **Impact on business**: This provision is assigned average importance.

5. **Possible solution**: In CEBS's view this provision is not intended to be a national discretion but a supervisory decision to be applied on a case by case basis. However, since exercising the discretion could cause administrative burden for supervisors and distortion of competition between institutions, the proposal is to **delete the provision completely**. The competent authorities that have specified a methodology for the calculation of institutions' deltas and consider it necessary can draw up guidelines for applying this methodology.

6. **Drafting proposal**: Deletion of Annex 4, point 10, Directive 2006/49/EC.

100. Trading book, Annex IV, point 10, three last paragraphs (Directive 2006/49/EC)

"The competent authorities may allow the requirement for a written exchange-traded commodity option to be equal to the margin required by the exchange if they are fully satisfied that (…). The competent authorities may also allow the capital requirement for an OTC commodity option cleared by a clearing house recognised by them to be equal to the margin required by the clearing house if (…). In addition they may allow the requirement on a bought exchange-traded or OTC commodity option to be the same as that for the commodity underlying it, subject to the constraint that the resulting requirement does not exceed the market value of the option. The requirement for a written OTC option shall be set in relation to the commodity underlying it."

Objective of the discretion: The objective of the discretion, when applied, is to allow institutions to use an alternative capital requirements calculation. This discretion, when applied, allows more permissive treatment in the capital requirement calculation.

1. **Overview of exercise:** 44% of the Member States have implemented this provision (7% with a proviso), 57% have not.

2. **Overview of responses:** 7 Members and 1 of industry's respondents wish to keep this national discretion in its present form; 9 Members favour removing it completely from the CRD; 3 Members and 5 industry respondents would rather transform it into an option for credit institutions; 3 Members and 1 respondent from the industry would prefer to transform it into a general rule and 8 respondents have no preference. The discretion is important for 4 respondents and fairly important for 13 respondents; 13 respondents find it irrelevant or are indifferent to it.

3. **Main drivers**: A key issue is whether reliance may be placed on margining requirements as an indicator for capital requirements. While three supervisors consider this provision a useful and adequate shortcut, one supervisor questions the value of margining requirements, citing in particular that

clearing houses do not provide transparency as regards their calculations. The industry cites convergence and a level playing field as key drivers of its call to transform the provision into an option for credit institutions.

4. **Impact on business**: This provision is assigned below average importance and importantly, a number of jurisdictions indicate that there is little experience with the provision or little relevant business or both.

5. **Possible solution**: This national discretion should be analysed in conjunction with discretions 86, 87, 89, 90 and 98. **See discretion number 86.**

6. **Drafting proposal**: Deletion of Annex 4, point 10, three last subparagraphs, Directive 2006/49/EC.

101. Trading book, Annex IV, point 14 (Directive 2006/49/EC)

"Competent authorities may allow positions which are, or are regarded pursuant to point 7 as, positions in the same commodity to be offset and assigned to the appropriate maturity bands on a net basis for the following:

(a) positions in contracts maturing on the same date; and

(b) positions in contracts maturing within 10 days of each other if the contracts are traded on markets which have daily delivery dates."

Objective of the discretion: This provision entails a more permissive treatment by extending the possibility for offsetting positions.

1. **Overview of exercise**: 90 % of Member States have implemented this provision.

2. **Overview of responses**: 2 respondent wish to remove the provision completely from the CRD. All the other respondents wish to keep the provision either as it is (6 Members and 2 of industry's respondents) or as an option for credit institutions (5 Members and 5 respondents from industry) or as a general rule (13 Members and 1 industry respondents).Given the implementation rate, the dispersion of responses is quite significant. However, the respondents calling for removal do not consider the provision to be critical.

3. **Main drivers**: Reasons provided for the most part remain generic. 2 supervisors quote the high degree of correlation, 1 points to Annex I, point 10 of Directive 2006/49/EC, where the same treatment is applied. The industry, whose majority calls for transformation into an option for banks suggests that the "divergent application of this provision would penalise institutions subject to stricter requirements".

4. **Impact on business**: This provision is assigned average importance.

5. **Possible solution**: As there is a consensus among respondents to retain the substance of the provision and the exercise of the discretion is advantageous to banks as it permits offsetting, i.e. reduction of positions, CEBS proposes to transform the discretion into **an option for credit institutions**.

6. **Drafting proposal**:

<u>Positions,</u> which are, or are regarded pursuant to point 7 as positions in the same commodity may be offset and assigned to the appropriate maturity band on a net basis for the following: (…).

ADDITIONAL PROVISIONS

Provisions included in this section are either mutual recognition clauses (and corresponding national discretions) or provisions brought to CEBS's attention by industry's respondents in their answers to the public questionnaire.

Area: CRM

102. CRM, Annex VIII, Part 1, point 16, 1st sentence (Directive 2006/48/EC)
"The competent authorities may waive the requirement for their credit institutions to comply with condition (b) in point 13 for exposures secured by residential real estate property situated within the territory of that Member State if the competent authority have evidence that (...)."

1. **Overview of exercise:** This discretion and its mutual recognition clause (103) were analysed by CEBS in its mutual recognition work. Based on data reported for the mutual recognition exercise, 40% of Member States have applied this discretion, 3% has not yet decided and for 57% Member States this discretion is not applicable.

2. **Possible solution:** As with the other discretions with respect to the real estate market it was agreed that local supervisors are best suited to asses whether these criteria are met for their markets. The industry agrees with this analysis with the exception of one respondent that considers that paragraph 16 should be removed immediately. CEBS is of the opinion that this discretion should be **kept as it is but adding a binding mutual recognition clause.**

3. **Drafting proposal:** No change necessary (for binding mutual recognition clause, see provision 103).

4. **Other remarks:** Competent authorities should fully disclose the manner of their exercise of this national discretion in the supervisory disclosure framework, if they do not do so already.

103. CRM, Annex VIII, Part 1, point 16, last sentence, (Directive 2006/48/EC)
"This shall not prevent the competent authorities of a Member State, which do not use this waiver from recognising as eligible residential real estate property recognised as eligible in another Member State by virtue of the waiver. Member States shall disclose publicly the use they make of this waiver."

1. **Overview of responses:** Based on data reported for the mutual recognition exercise, 20 Members will recognise, as a principle, host rules for this discretion at a consolidated level in all cases; 4 Members will do it but only when the relative importance of the specific subsidiary in the total group is

low and consolidated solvency is not eroded; 5 Members will only recognize host rules in other specific circumstances; and 1 Member will not.

2. **Possible solution: See provision 102.**

3. **Drafting proposal:** Transforming it into a binding mutual recognition clause.

The competent authorities of a Member State which do not use the waiver <u>shall</u> recognise as eligible residential real estate property recognised as eligible in another Member State by virtue of the waiver. Member States shall disclose publicly the use they make of the waiver.

104. CRM, Annex VIII, Part 1, point 17 (Directive 2006/48/EC)
"The competent authorities of the Member States may waive the requirement for their credit institutions to comply with the condition in point 13(b) for commercial real estate property situated within the territory of that Member State, if the competent authorities have evidence that the relevant market is well-developed and long-established and that loss-rates stemming from lending secured by commercial real estate property satisfy the following conditions (…)"

1. **Overview of exercise**: This national discretion and its mutual recognition clause (105) are similar to numbers 102 and 103. These were also analysed in the context of CEBS's work on mutual recognition and as according to this analysis 20% of Member States have applied this discretion, 3% have not yet finally decided and for 77% of the Member States this discretion is not applicable.

2. **Overview of responses:** Although this discretion was not included in the questionnaire, feedback from some industry respondents was received. The industry agrees on binding mutual recognition, with the exception of 1 credit institution that considers that paragraph 17 should be removed immediately.

3. **Possible solution:** As with the other discretions with respect to the real estate market it was agreed that local supervisors are best suited to assess whether these criteria are met for their markets. This allows local assessment of contract law, real estate law, bankruptcy law and market circumstances, though which the level playing field for all institutions active in that market should be ensured. CEBS is therefore of the opinion that this discretion should be **kept as it is but adding a binding mutual recognition clause.** The supervisory disclosure framework would have to be amended to include information on the exercise of this discretion.

4. **Drafting proposal:** No change necessary (for the binding mutual recognition clause see provision 105).

5. **Other remarks:** Competent authorities should fully disclose the manner of their exercise of this national discretion in the supervisory disclosure framework, if they do not do so already.

105. CRM, Annex VIII, Part 1, point 19 (Directive 2006/48/EC)

"The competent authorities of a Member State may recognise as eligible collateral commercial real estate property recognised as eligible collateral in another Member State by virtue of the waiver provided for in point 17".

1. **Overview of responses:** Based on data reported for the mutual recognition exercise, 19 Members will recognise in all cases, as a principle, host rules for this discretion at a consolidated level; 4 Members will recognise it only when the relative importance of the specific subsidiary in the total group is low and consolidated solvency is not eroded; 5 only in other specific circumstances; and 2 Members will not recognise it.

2. **Possible solution: See provision 104.**

3. **Drafting proposal:** Transforming it into a binding mutual recognition clause.

The competent authorities of a Member State shall recognise as eligible collateral commercial real estate property recognised as eligible collateral in another Member State by virtue of the waiver provided for in point 17

106. CRM, Annex VIII, Part 1, point 25 (Directive 2006/48/EC)

"Instruments issued by third party institutions which will be repurchased by that institution on request may be recognised as eligible credit protection."

1. **Possible solution**: This provision is not a national discretion nor a supervisory decision. This provision is part of the list of "other funded credit protection" considered eligible for the purpose of credit risk mitigation. In the current wording of the Directive, the use of these kinds of instruments is **an option for institutions.**

2. **Drafting proposal**: No changes necessary because the provision is an option for credit institutions. To clarify this, the Commission could consider replacing the word 'recognised' by 'used'.

107. CRM, Annex VIII, Part 1, point 8 (Directive 2006/48/EC)

"Debt securities issued by institutions which securities do not have a credit assessment by an eligible ECAI may be recognised as eligible collateral if they fulfil the following criteria: (…)".

1. **Possible Solution:** This provision is not a national discretion or a supervisory decision. It is a provision that specifies part of the list of collateral that is eligible under all approaches and methods. In the current wording of the Directive, the use of these kinds of instruments is **an option for credit institutions, subject to the fulfilment of a set of conditions**. Competent

authorities should be satisfied that those conditions are met as part of their on-going supervision activities.

2. **Drafting proposal:** No changes necessary because the provision is an option for credit institutions. To clarify this, the Commission could consider replacing the word 'recognised' by 'used'.

108. CRM, Annex VIII, Part 2, point 16 (Directive 2006/48/EC)

"Where an exposure is protected by a guarantee which is counter-guaranteed by a central government or central bank, a regional government or local authority, a public sector entity, claims on which are treated as claims on the central government in whose jurisdiction they are established under Articles 78 to 83, a multi-lateral development bank to which a 0 % risk weight is assigned under or by virtue of Articles 78 to 83, or a public sector entity, claims on which are treated as claims on credit institutions under Articles 78 to 83, the exposure may be treated as protected by a guarantee provided by the entity in question, provided the following conditions are satisfied: (…)"

1. **Possible Solution**: This provision is not a national discretion or a supervisory decision. In the current wording of the Directive, this is **an option for institutions, subject to the fulfilment of a set of defined conditions**. Competent authorities should be satisfied that those conditions are met as part of their on-going supervision activities.

2. **Drafting proposal**: No changes necessary because the provision is an option for credit institutions.

109. CRM, Annex VIII, Part 3, point 59 (Directive 2006/48/EC)

"Where a competent authority permits the treatment set out in point 58 to be applied in the case of repurchase transactions or securities lending or borrowing transactions in securities issued by its domestic government, then other competent authorities may choose to allow credit institutions incorporated in their jurisdiction to adopt the same approach to the same transactions."

1. **Possible Solution** This provision is meant to be a mutual recognition clause. Since the provision in Annex VIII, Part 3, point 58 to which it refers is not a national discretion any more – in a draft version of the Directive it was in fact a national discretion - but an option for credit institutions (subject to compliance with the defined conditions), this **mutual recognition clause should be deleted from the CRD**.

2. **Drafting proposal**: Deletion of Annex VIII, Part 3, point 59.

110. CRM, Annex VIII, Part 3, point 73 (Directive 2006/48/EC)

"Subject to the requirements of this point and point 74 and as an alternative to the treatment in points 68 to 72, the competent authorities of a Member State may authorise credit institutions to assign a 50 % risk weight to the Part of the exposure fully collateralised by residential real estate property or commercial real estate property situated within the territory of the Member State if they have evidence that the relevant markets are well-developed and long-established with loss-rates from lending collateralised by residential real estate property or commercial real estate property respectively that do not exceed the following limits (…)"

1. **Overview of exercise:** Based on data reported for CEBS's mutual recognition exercise, 40% of Member States exercised this option, 57% of Member States have not recognised it and 7%, at that time, had not yet decided.

2. **Possible solution**: This discretion allows for a less demanding treatment in the calculation of the mitigating effects of real estate collateral for those institutions applying the IRB approach. The treatment entailed in this discretion may only be authorised by competent authorities if they have evidence that local markets are well developed and long established and that loss rates from RRE and CRE loans do not exceed the specified limits. Therefore, the exercise of this option is rooted in local market conditions/specificities. Consistent with previous proposals (please see provisions 102 to 105 and 136 to 143), the proposal is to **keep this provision in the present form but with a binding mutual recognition clause** to avoid distortions in the level playing field (see provision 111). The supervisory disclosure framework would have to be amended to include information on the exercise of this discretion.

3. **Drafting proposal**: No changes necessary (for binding mutual recognition clause, see provision 111).

4. **Other remarks:** Competent authorities should fully disclose the manner of their exercise of this national discretion in the supervisory disclosure framework, if they do not do so already.

111. CRM, Annex VIII, Part 3, point 75 (Directive 2006/48/EC)

"The competent authorities, which do not authorise the treatment in point 73, may authorise credit institutions to assign the risk weights permitted under this treatment in respect of exposures collateralised by residential real estate property of commercial real estate property respectively located in the territory of those Member States the competent authorities of which authorise this treatment subject to the same conditions as apply in that Member State."

1. **Overview of exercise**: Based on the data reported for CEBS's mutual recognition exercise, 97% of Members (including 37% that would do it subject to conditions) indicated that they would, as home supervisors, recognise, as a principle, host rules for this discretion at a consolidated level.

2. **Possible solution:** This is a mutual recognition clause relating to the alternative treatment provided for in Annex VIII, Part 3, point 73. The objective is to minimise costs arising from competition distortions that result from differences in legal frameworks between Member States. As the local supervisor is typically in the best position to assess whether the requirements referring to local market conditions are met, the consolidating/home supervisor should apply recognition of the host rules for this discretion at a consolidated level. As referred to in 110, **this mutual recognition clause should be transformed into a binding provision**. As a result it should not be included in the supervisory disclosure framework. Nevertheless, those Members that apply this national discretion shall disclose information regarding their practical understanding of compliance with the conditions set in the Directive.

3. **Drafting proposal**: Transforming it into a binding mutual recognition clause.

"The competent authorities, which do not authorise the treatment in point 73, shall authorise credit institutions to assign the risk weights permitted under this treatment in respect of exposures collateralised by residential real estate property or commercial real estate property respectively located in the territory of those Member States the competent authorities of which authorise this treatment subject to the same conditions as apply in that Member State."

Area: IRB

112. IRB, Annex VII, Part 4, point 44, last sentence (Directive 2006/48/EC)
"In all cases, the exposure past due shall be above the threshold defined by the competent authorities and which reflects a reasonable level of risk"

1. **Possible solution**: CEBS believes that more time is necessary to gain experience on this discretion, after which the need for it can be assessed. Therefore a preliminary proposal is to **keep the national discretion as it is. CEBS is seeking respondents' views on the costs and benefits of its tentative proposal and also on the actual need for this discretion.**

2. **Drafting proposal:** No change necessary.

113. IRB, Annex VII, Part 4, point 48, 1st and 2nd sentence (Directive 2006/48/EC)
"For retail and PSE exposures, the competent authorities of each Member States shall set the exact number of days past due that all credit institutions in its jurisdiction shall abide by under the definition of defaults set out in §44, for exposures to such counterparts situated within this Member State. The specific number shall fall within 90-180 days and may differ across product lines. (...)"

1. **Possible solution:** This is an important discretion, since it deals with one of the most debated issues in the IRB framework: the definition of default. There is still an inconsistency between the Standardised and the IRB approaches as regards the number of days past due for retail and PSEs exposures: in the former, the option to set a number up to 180 days is possible only up to 2011, as for corporate exposures. The behaviour of counterparties is quite different across Members as well as between retail and PSEs. CEBS believes that more time is necessary to assess the need for this national discretion; therefore a preliminary proposal is to **keep the discretion as it is, possibly with the introduction of a review clause**. **CEBS is seeking respondents' views on the costs and benefits of its tentative proposal and also on the actual need for this national discretion.**

2. **Drafting proposal:** No change necessary except the addition of a review clause.

(…) <u>Before 30 December 2014 this provision shall be reviewed.</u>

114. IRB, Annex VII, Part 4, point 48, last sentence (Directive 2006/48/EC)
"For exposures to such counterparts situated in the territories of other Member States, the competent authorities shall set a number of days past due which is not higher than the number set by the competent authority of the respective Member State."

1. **Possible solution:** This is the mutual recognition clause for the discretion in 113: as such, the consolidating/home supervisor can recognise the host rules for this discretion at a consolidated level. See provision 113 for the reasoning behind the provision. Further experience should be gained. As this reflects a basic difference in supervisory opinions, binding mutual recognition cannot be proposed at this stage. Therefore CEBS's proposal is to **keep the mutual recognition clause in the present form**.

2. **Drafting proposal:** No change necessary.

115. IRB, Article 85.1 and 85.2 (Directive 2006/48/EC)
"(…) Subject to the approval of the competent authorities, implementation may be carried out sequentially across the different exposure classes (…) (…) Implementation as referred to in paragraph 1 shall be carried out within a reasonable period of time to be agreed by the competent authorities(…)"

1. **Possible solution:** This provision is not a national discretion but a supervisory decision that is part of the overall IRB supervisory approval process. The proposal is to **keep it as a supervisory decision.**

2. **Drafting proposal:** No change necessary since the provision is part of the IRB supervisory approval process.

116. IRB, Article 89.1 last sentence (Directive 2006/48/EC)

"This paragraph shall not prevent the competent authorities of other Member States to allow the application of the rules of Subsection 1 (standardised approach) for equity exposures which have been allowed for this treatment in other Member States"

1. **Overview of exercise**: This **mutual recognition clause** and the corresponding national discretions (see 118 and 119) were analysed in the context of CEBS's mutual recognition work. According to this analysis 70% of the Member States have applied this discretion, 3% has not yet decided and for 20% of the Member State this discretion is not applicable.

2. **Overview of responses:** 14 Member States would recognise in all cases host rules for this discretion at a consolidated level; 4 Members would recognize them but only when the relative importance of the specific subsidiary in the total group is low and consolidated solvency is not eroded; and 5 Members only in other specific circumstances. 5 supervisors answered that they as a host would (also) allow the use of the standardised approach for these exposures at the solo level as part of the joint-decision process

3. **Mutual recognition proposal:** Specific types of equity exposures can be permanently exempted from the IRB. The local supervisor is typically in the best position to assess whether the specific equity exposures in its market meet the requirements and that application of the standardised approach is justifiable.

   As such, the consolidating/home supervisor will apply recognition of the host rules for this discretion at a consolidated level. Depending on the specifics of the situation this recognition can be either unconditional or conditional. Conditions that are applied in assessing recognition: i) use of the standardised approach for these exposures is in line with the overall specifics of the IRB application of the institution in question; ii) relatively low importance of the specific exposures in total group solvency; iii) consolidation of sub/branch by aggregation instead of line by line; and iv) proper risk profile and management of the group as a whole.

   If the importance of the specific exposures in total group solvency is not low, recognition could still be applied after further analysis has been done. In this analysis possible arguments of competitive disadvantage are relevant elements to assess.

4. **Drafting proposal:** See provision 117. It would also be useful to clarify in the text that the mutual recognition only applies to points (f) and (g).

117. IRB, Article 89.1 (Directive 2006/48/EC)

"Subject to the approval of the competent authorities, credit institutions permitted to use the IRB approach (…) for one or more exposure classes may apply Subsection 1 (standardised approach) for the following (…)"

1. **Possible solution:** This provision is not a national discretion. It sets out the criteria in a useful manner to both industry and supervisors for the building and assessment of models for the IRB. However since the wording is not clear the **Commission should clarify it. Views from respondents are sought whether it would be adequate to distinguish between the two following cases**:

   - those provisions which imply supervisory decisions to be taken on a case by case basis. These are part of the IRB approval process (paragraphs a), b) c) of Article 89.1).

   -those provisions which imply a general decision by the supervisor and which therefore will be applied to all institutions in its jurisdiction (paragraphs d), e) f) g), h) i) of Article 89.1).

2. **Drafting proposal***:* None at this time.

118. IRB, Article 89.1 (f) (Directive 2006/48/EC)

Credit institutions permitted to use the IRB approach may apply the Standardised approach for "equity exposures to entities whose credit obligations qualify for a 0% risk weight under subsection 1" (Standardised approach)

See provision 117.

119. IRB, Article 89.1 (g) (Directive 2006/48/EC)

Credit institutions permitted to use the IRB approach may apply the Standardised approach for "equity exposures incurred under legislative programmes (…)".

See provision 117.

Area: Large Exposures

(This area is not within the scope of the CEBS's National Discretions mandate because it is included in the current review of the large exposures regime)

120. Large Exposures, Article 110.3 (Directive 2006/48/EC)

"Member States may require credit institutions to analyse their exposures to collateral issuers for possible concentrations and where appropriate take action or report any significant findings to their competent authority".

See above.

121. Large Exposures, Article 114.1 (Directive 2006/48/EC)

"Subject to paragraph 3, for the purposes of calculating the value of exposures for the purposes of Article 111(1) to (3) Member States may, in respect of credit institutions using the Financial Collateral Comprehensive Method under Articles 90 to 93, in the alternative to availing of the full or partial exemptions permitted under points (f), (g), (h), and (o) of Article 113(3), permit such credit institutions to use a value lower than the value of the exposure, but no lower than the total of the fully-adjusted exposure values of their exposures to the client or group of connected clients. (…)".

See above.

122. Large Exposures, Article 114.2 (Directive 2006/48/EC)

"Subject to paragraph 3, a credit institution permitted to use own estimates of LGDs and conversion factors for an exposure class under Articles 84 to 89 may be permitted, where it is able to the satisfaction of the competent authorities to estimate the effects of financial collateral on their exposures separately from other LGD relevant aspects, to recognise such effects in calculating the value of exposures for the purposes of Article 111(1) to (3). (…) Credit institutions permitted to use own estimates of LGDs and conversion factors for an exposure class under Articles 84 to 89 which do not calculate the value of their exposures using the method referred to in the first subparagraph may be permitted to use the approach set out in paragraph 1 or the exemption set out in Article 113(3)(o) for calculating the value of exposures. A credit institution shall use only one of these two methods".

See above.

123. Large Exposures, Article 114.4 (Directive 2006/48/EC)

"Where the effects of collateral are recognised under the terms of paragraphs 1 or 2, Member States may treat any covered Part of the exposure as having been incurred to the collateral issuer rather than to the client."

See above.

Area: Operational risk

124. Op Risk, Annex X, Part 3, Point 11 (Directive 2006/48/EC)

"Correlations in operational risk losses across individual operational risk estimates may be recognised only if credit institutions can demonstrate to the satisfaction of the competent authorities that their systems for measuring correlations are sound, implemented with integrity, and take into account the uncertainty surrounding any such correlation estimates, particularly in periods of stress. The credit institution must validate its correlation assumptions using appropriate quantitative and qualitative techniques."

1. **Possible solution:** This is a discretion proposed for review by the industry. The objective of the discretion, when granted, is to allow for the recognition of correlations in Operational Risk losses in the AMA approach where correlations arise from risk estimates. Member States may grant the waiver as part of the AMA approval process. This will affect credit institutions seeking AMA approval and a waiver to allow for the recognition of correlations in Operational Risk losses where correlations arise from risk estimates. Industry responses are consistent with changing the wording of the Directive to replace competent authority optional oversight with a general rule. The removal of this option is straightforward as the competent authorities retain supervisory oversight, in that they will not be able to grant the waiver unless the credit institution satisfies the competent authority on the criteria described. However, it must be noted that on the basis of Cost/Benefit Analysis there is probably little benefit to either the competent authorities or the credit institutions in changing the wording of this particular point in the Annex. It is proposed to **delete the discretionary part of the provision**, as it is part of the model approval process.

2. **Drafting proposal:**

Correlations in operational risk losses across individual operational risk estimates <u>shall</u> be recognised only if credit institutions can demonstrate to the satisfaction of the competent authorities that their systems for measuring correlations are sound, implemented with integrity and take into account the uncertainty surrounding any such correlation estimates, particularly in periods of stress. The credit institution must validate it's correlation assumptions using appropriate quantitative and qualitative techniques.

Area: Securitisation

125. Securitisation, Annex IX, Part 4, point 43 (Directive 2006/48/EC)

"Subject to the approval of the competent authorities, when the following conditions are satisfied a credit institution may attribute to an unrated position in an ABCP programme a derived rating as laid down in point 44: (…)"

1. **Possible solution:** This provision is not a national discretion; it is a supervisory decision exercised on a case by case basis because the provision sets out conditions which have to be met and supervisors are required to determine whether the conditions have been met in each case. The proposal is to **keep the supervisory decision in its present form.**

2. **Drafting proposal:** No change necessary at the CRD level, but the provision should be implemented as a supervisory decision at the national level.

126. Securitisation, Annex IX, part 4, point 43, last sentence (Directive 2006/48/EC)

"The requirement for the assessment methodology of the ECAI to be publicly available may be waived by the competent authorities where they are satisfied that due to the specific features of the securitisation — for example its unique structure — there is as yet no publicly available ECAI assessment methodology"

1. **Possible solution:** This is not a national discretion but a supervisory decision exercised on a case by case basis by the competent authorities. The use of this supervisory decision is understood to be an exceptional measure: a securitisation structure often consists of different pools of assets for which a rating and a publicly available ECAI assessment methodology will normally exist. Exceptionally there might be cases of unusual asset classes that are part of the securitisation structure, for which no such ratings/assessment methodologies exist. It is for this exceptional situation that this supervisory decision was created. Therefore, the proposal is to **keep the supervisory decision in its present form**.

2. **Drafting proposal:** No change necessary at the CRD level, but the provision should be implemented as a supervisory decision at the national level.

127. Securitisation, Annex IX, Part 4, point 58 (Directive 2006/48/EC)

"When it is not practical for the credit institution to calculate the risk-weighted exposure amounts for the securitised exposures as if they had not been securitised, a credit institution may, on an exceptional basis and subject to the consent of the competent authorities, temporarily be allowed to apply the method set out in point 59 for the calculation of risk-weighted exposure amounts for an unrated securitisation position in the form of a liquidity facility that meets the conditions to be an 'eligible liquidity facility' set out in point 13 or that falls within the terms of point 56."

1. **Possible solution:** This is not a national discretion but a supervisory decision to be taken by competent authorities on a case by case basis if and when necessary. This is reflected in the wording of the provision: i.e. 'on an exceptional basis' and 'temporarily be allowed'), and it should thus be available for supervisors and cannot be a general rule. The proposal is to **keep the supervisory decision in its present form** and the Member States that have not yet implemented this provision as a supervisory decision to be used on a case by case basis should be urged to do so as soon as possible.

2. **Drafting proposal:** No change necessary at the CRD level, but the provision should be implemented as a supervisory decision at the national level.

128. Securitisation, Article 97.1 (Directive 2006/48/EC)

"An ECAI credit assessment may be used to determine the risk weight of a securitisation position in accordance with Article 96 only if the ECAI has been recognised as eligible by the competent authorities for this purpose (hereinafter 'an eligible ECAI')."

1. **Possible solution**: This is not a national discretion. It is a general rule stating that only ratings from recognized ECAIs are allowed to be used by any credit institution which would like to do so when determining the securitisation position in accordance with article 96. The proposal is to **keep the possibility of using the ECAIs' credit assessment as an option for credit institutions**.

2. **Drafting proposal:** No change necessary since it is an option for credit institutions.

129. Securitisation, Article 97.2 (Directive 2006/48/EC)

"The competent authorities shall recognise an ECAI as eligible for the purposes of paragraph 1 only if they are satisfied as to its compliance with the requirements laid down in Article 81, taking into account the technical criteria in Annex VI, Part 2, and that it has a demonstrated ability in the area of securitisation, which may be evidenced by a strong market acceptance."

1. **Possible solution:** This is not a national discretion, it is a general rule stating the criteria for the recognition of the ECAIs for ratings of securitisation positions. The determination of whether these criteria have been met involves a case by case decision of the supervisor and therefore this is not a national discretion, but a supervisory decision. The proposal is to **keep the supervisory decision in its present form** and the Member States that have not yet implemented this provision as a supervisory decision to be used on a case by case basis should be urged to do so as soon as possible.

2. **Drafting proposal:** No change necessary at the CRD level, but the provision should be implemented as a supervisory decision at the national level.

130. Securitisation, Article 97.3 (Directive 2006/48/EC)

"If an ECAI has been recognised as eligible by the competent authorities of a Member State for the purposes of paragraph 1, the competent authorities of other Member States may recognise that ECAI as eligible for those purposes without carrying out their own evaluation process."

1. **Possible solution**: The CRD allows Member States to recognise an ECAI as eligible in two ways: direct recognition, in which the competent authority carries out its own assessment of the ECAI's compliance with the CRD's eligibility criteria; and indirect recognition in which the competent authority recognises the ECAI without carrying out its own evaluation, relying instead on the recognition of the ECAI by the competent authority of another Member

State. A common understanding of the recognition criteria and processes has been developed to support consistency in direct recognition decision making across the EU and to increase the scope for indirect recognition (see CEBS Guidelines on the recognition of ECAIs released on 20 January 2006). Additionally, and in order to avoid the inefficiencies of sequential direct recognition processes in cases where applications from the same ECAI are received by a number of competent authorities, those competent authorities will participate in a 'joint assessment process' to assess together the ECAI's eligibility. Recognising that the CRD requires a decision by each competent authority, where a shared view is achieved, this should form the basis for national decision making. This is not a national discretion but a method for ensuring a harmonized approach. The proposal is to include in the CRD the **requirement for a joint assessment process.**

2. **Drafting proposal:**

> '*<u>Before an ECAI is recognised as eligible for the purposes of 97.1, the competent authority shall invite all other competent authorities to whom an application has been made to participate in a joint assessment of the ECAI. If, as a result of the assessment process,</u> an ECAI has been recognised as eligible for the purposes of paragraph 1 <u>by any Member State</u>, the competent authorities of other Member States may recognise that ECAI as eligible for those purposes without carrying out their own evaluation process.*

131. Securitisation, Article 98.1 (Directive 2006/48/EC)

"For the purposes of applying risk weights to securitisation positions, the competent authorities shall determine with which of the credit quality steps set out in Annex IX the relevant credit assessments of an eligible ECAI are to be associated. Those determinations shall be objective and consistent."

1. **Possible solution:** The CRD requires a separate mapping of credit assessments of securitisation positions which follows the same principles of objectivity and consistency as the fundamentals mapping. The main reasons for this distinction are: first, securitisation transactions have unique characteristics, and the market is highly innovative and constantly evolving. Second, securitisation mapping under the Internal Risk Based (IRB) Approach would be more finely graduated than the mapping of general credit assessments under the Standardised Approach. This is not a national discretion but a method to ensure a harmonized approach. The proposal is to include in the CRD the **requirement for a joint assessment process.**

2. **Drafting proposal**:

> *For the purposes of applying risk weights to securitisation positions<u>, the competent authority shall invite all other competent authorities to whom an application has been made to participate in the joint process with the aim</u> of determining with which of the credit quality steps set out in Annex IX the relevant credit assessments of an eligible ECAI are to be associated. Those determinations shall be objective and consistent.*

132. Securitisation, Article 98.2 (Directive 2006/48/EC)

"When the competent authorities of a Member State have made a determination under paragraph 1, the competent authorities of other Member States may recognise that determination without carrying out their own determination process."

1. **Possible solution:** This is not a national discretion. This is the **indirect recognition clause** corresponding to Article 98.1 (national discretion number 131). The CRD allows Member States to determine the securitisation mapping in two ways: directly, when the competent authority carries out its own determination process (which may be through a joint assessment process); or indirectly, when the competent authority relies on the determination process of a competent authority of another Member State. The latest would be the most natural decision when the ECAI is indirectly recognised according to article 97.3.
2. **Drafting proposal:** No change necessary because it is an indirect recognition clause.

Area: Standardised Approach

133. Standardised Approach, Annex VI, Part 1, point 29 (Directive 2006/48/EC)

"Exposures to institutions with an original effective maturity of more than three months for which a credit assessment by a nominated ECAI is available shall be assigned a risk weight according to Table 4 in accordance with the assignment by the competent authorities of the credit assessments of eligible ECAIs to six steps in a credit quality assessment scale".

See provision 135.

134. Standardised Approach, Annex VI, Part 1, point 31 (Directive 2006/48/EC)

"Exposures to an institution with an original effective maturity of three months or less for which a credit assessment by a nominated ECAI is available shall be assigned a risk weight according to Table 5 in accordance with the assignment by the competent authorities of the credit assessments of eligible ECAIs to six steps in a credit quality assessment scale"..

See provision 135.

135. Standardised Approach, Annex VI, Part 1, point 41 (Directive 2006/48/EC)
"Exposures for which a credit assessment by a nominated ECAI is available shall be assigned a risk weight according to Table 6 in accordance with the assignment by the competent authorities of the credit assessments of eligible ECAIs to six steps in a credit quality assessment scale".

1. **Possible solution:** None of these provisions is a national discretion; they are **general provisions** saying that the assignment of risk weights shall be based on the assignment by the competent authorities of the credit assessments of eligible ECAIs to six steps in a credit quality assessment scale. There are two corresponding mutual recognition clauses (see provisions 148 and 149) which introduce the possibility of a joint assessment/determination process to allow for a harmonised approach. To ensure this harmonized approach the proposal is to include in the CRD the requirement for a joint assessment process as is the current practice.

2. **Drafting proposal**: No change necessary.

136. Standardised Approach, Annex VI, Part 1, point 49 (Directive 2006/48/EC)
"Competent authorities may dispense with the condition contained in point 48(b) for exposures fully and completely secured by mortgages on residential property which is situated within their territory, if they have evidence that a well-developed and long-established residential real estate market is present in their territory with loss rates which are sufficiently low to justify such treatment". Point 48(b): "the risk of the borrower does not materially depend upon the performance of the underlying property or project, but rather on the underlying capacity of the borrower to repay the debt from other sources. As such, repayment of the facility does not materially depend on any cash flow generated by the underlying property serving as collateral"

1. **Overview of exercise:** Based on the data reported for CEBS's mutual recognition exercise, 13 Member States (43%) have exercised this national discretion and 16 Member States (53%) have not exercised it.

2. **Possible solution:** This national discretion allows Member States to assign a reduced risk weight (35% instead of 100%) to exposures secured by mortgages on residential property which is situated within their territory, if the local market fulfils certain requirements. The exercise of this discretion is based on local market conditions. In qualifying exposures secured by mortgages on residential property for a 35% risk weight, the competent authorities may waive from the required criteria the condition that the risk of the borrower should not materially depend on the performance of the underlying property, if a well developed and long established market exists in the territory with sufficiently low loss rates to justify such treatment. In general only local supervisors are in a position to assess whether these

preconditions are met in their local market in order to justify the application of the waiver. This national discretion is subject to an explicit mutual recognition clause (see provision 137). As this national discretion is rooted in local market conditions, it is proposed to **keep this discretion in the present form** (see provision 137 for the level playing field proposal).

3. **Drafting proposal:** No changes necessary.

4. **Other remarks:** Competent authorities should fully disclose the manner of their exercise of this national discretion in the supervisory disclosure framework, if they do not do so already.

137. Standardised Approach, Annex VI, Part 1, point 50 (Directive 2006/48/EC)
"When the discretion contained in point 49 is exercised by the competent authorities of a Member State, the competent authorities of another Member State may allow their credit institutions to assign a risk weight of 35% to such exposures fully and completely secured by mortgages on residential property".

1. **Overview of exercise:** Based on the data disclosed under the supervisory disclosure framework, 15 Member States have exercised this mutual recognition (one with conditions, i.e. on a case by case basis). CEBS's stock take on mutual recognition of June 2007 indicated that 20 Member States will recognise other Member States' assessment in all cases; 5 only when the relative importance of the specific subsidiary in the total group is low and consolidated solvency is not eroded, 4 only in other specific circumstances and 1 will not recognise them.

2. **Possible solution:** This national discretion allows a Member State to recognise the treatment by another Member State of certain exposures secured by mortgages on residential property. Exercising this mutual recognition clause results in a risk weight of 35% if the respective Member State has exercised the national discretion in point 49 and a risk weight of 100% if it has not exercised the national discretion in its jurisdiction. In general local supervisors are in a better position to assess whether the local market in its jurisdiction is well developed and long established and if loss rates are sufficiently low to justify the application of the waiver. As all Members currently disclosing their national transposition of this mutual recognition clause do exercise it and as the CEBS's stock take does show strong willingness to recognise the national treatment of such exposures, it is proposed to turn this mutual recognition into an **option for credit institutions**.

3. **Drafting Proposal:**

When the discretion contained in point 49 is exercised by the competent authorities of a Member State, <u>credit institutions may</u> assign a risk weight of 35% to such exposures fully and completely secured by mortgages on residential property.

138. Standardised Approach, Annex VI, Part 1, point 51 (Directive 2006/48/EC)

"Subject to the discretion of the competent authorities, exposures or any part of an exposure fully and completely secured, to the satisfaction of the competent authorities, by mortgages on offices or other commercial premises situated within their territory may be assigned a risk weight of 50%.

1. **Overview of exercise:** Based on data reported for the mutual recognition exercise, 16 Member States (53%) have exercised this national discretion and 14 Member States (47%) have not exercised it.

2. **Possible solution:** This national discretion allows Member States to assign a reduced risk weight (50% instead of 100%) to (parts of) exposures secured by mortgages on offices or other commercial premises situated within their territory when certain conditions are met. The criteria for this lower risk weight are explicitly stated in Annex VI point 54. In general, local supervisors are in a better position to assess whether the local market conditions in its jurisdiction justify the exercise of this discretion. This national discretion is subject to an explicit mutual recognition clause (see provision141). As this national discretion is rooted in local market conditions, it is proposed to **keep this discretion** in the present form. See provision 141 for the level playing field proposal.

3. **Drafting proposal:** No changes necessary.

4. **Other remarks:** Competent authorities should fully disclose the manner of their exercise of this national discretion in the supervisory disclosure framework, if they do not do so already.

139. Standardised Approach, Annex VI, Part 1, point 52 (Directive 2006/48/EC)

"Subject to the discretion of the competent authorities, exposures fully and completely secured, to the satisfaction of the competent authorities, by shares in Finnish housing companies, operating in accordance with the Finnish Housing Company Act of 1991 or subsequent equivalent legislation, in respect of offices or other commercial premises may be assigned a risk weight of 50%".

1. **Overview of exercise:** Based on the data gathered in the context of CEBS's work on mutual recognition. 12 Member States (40%) have exercised this national discretion and 16 Member States (53%) have not exercised it.

2. **Possible solution:** CEBS's view is that this provision is not intended to be a national discretion, but a supervisory decision to be applied on a case by case basis that should have been implemented by all Member States. This discretion allows Member States to assign a reduced risk weight (50% instead of 100%) to certain exposures secured by shares in Finnish housing

companies when certain conditions are met. This discretion is directly related to the local, Finnish, conditions. The wording of the discretion suggests that each supervisor makes his own, independent judgement on whether the conditions for applying the discretions are met. In practice, however, the application of this discretion (and mutual recognition) will very much depend on the assessment of the Finnish supervisor. It is highly unlikely that any supervisor would allow a 50% risk weight for an exposure that would not be allowed by the Finnish supervisor itself. It is in the best position to assess whether specific shares in Finish housing companies operate within the Finnish Housing Company Act of 1991 or equivalent legislation in respect of offices and other commercial premises. If any other supervisor allows the lower risk weight it will probably depend on the decision of the Finnish supervisor. The local Finnish conditions are the relevant conditions to consider. In this context the proposal is to **transform the national discretion into a supervisory decision by the local competent authorities, but based on the satisfaction of the Finnish competent authority as to whether the criteria have been met.** This discretion is subject to an explicit mutual recognition clause that should be deleted (see provision 141).

3. **Drafting proposal**:

Subject to the discretion of the competent authorities, exposures fully and completely secured, <u>to the satisfaction of the Finnish competent authority,</u> by shares in Finnish housing companies, operating in accordance with the Finnish Housing Company Act of 1991 or subsequent equivalent legislation, in respect of offices and other commercial premises may be assigned a risk weight of 50%.

140. Standardised Approach, Annex VI, Part 1, point 53 (Directive 2006/48/EC)

"Subject to the discretion of the competent authorities, exposures related to property leasing transactions concerning offices or other commercial premises situated in their territories under which the credit institution is the lessor and the tenant has an option to purchase may be assigned a risk weight of 50% provided that the exposure of the credit institution is fully and completely secured to the satisfaction of the competent authorities by its ownership of the property".

1. **Overview of exercise:** Based on data reported for the mutual recognition exercise, 12 Member States (40%) have exercised this national discretion and 17 Member States (57%) have not exercised it.

2. **Possible solution:** This national discretion allows Member States to assign a reduced risk weight (50% instead of 100%) to certain exposures related to property leasing transactions for offices or other commercial premises situated in their territories when certain conditions are met. The criteria for this lower risk weight are explicitly stated in Annex VI point 54. In general, local supervisors are in a better position to assess whether the local market conditions in their jurisdictions justify the exercise of this discretion. This

national discretion is subject to an explicit mutual recognition clause (see provision 141). As this national discretion is rooted in local market conditions, it is proposed to **keep this discretion in the present form**. See provision 141 for the level playing field proposal.

3. **Drafting proposal:** No change necessary.

4. **Other remarks:** Competent authorities should fully disclose the manner of exercise of this national discretion in the supervisory disclosure framework, if they do not do so already.

141. Standardised Approach, Annex VI, Part 1, point 57 (Directive 2006/48/EC)
"When the discretion contained in points 51 to 53 is exercised by the competent authorities of one Member State, the competent authorities of another Member State may allow their credit institutions to risk weight at 50% such exposures fully and completely secured by mortgages on commercial property".

1. **Overview of exercise:** Based on the information disclosed in the supervisory disclosure framework on national websites:

   - with reference to point 51: 15 Member States have exercised this mutual recognition (1 on a case by case basis), 1 Member State has not exercised this mutual recognition. CEBS's stock take in 2007 indicated that 21 Members support recognition in all cases, 5 support recognition, under certain conditions and 1 opposes recognition given the general high risk character of commercial real estate collateral.

   - with reference to point 52: 11 Member States have exercised this mutual recognition (1 on a case by case basis), 5 Member States have not exercised this mutual recognition. CEBS's stock take in 2007 indicated that 16 Members support recognition in all cases, 9 support recognition under certain conditions and 3 oppose recognition as it is deemed not relevant for 'own' institutions and as such not foreseen in national implementation.

   - with reference to point 53: 13 Member States have exercised this mutual recognition (1 on a case by case basis), 3 Member States have not exercised this mutual recognition. CEBS's stock take in 2007 indicated that 21 Members support recognition in all cases, and 9 support recognition under certain conditions.

2. **Possible solution:**

   - with reference to point 51 (see provision 138): This national discretion allows a Member State to recognise the treatment by another Member States of certain exposures secured by mortgages on offices or other commercial premises situated within that Member State, i.e. irrespective of whether or not the national discretion contained in point 51 is exercised in the Member State itself. When exercising this mutual recognition clause, the treatment by another Member State is recognised for such exposures in that Member State.

- with reference to point 52 (see provision 139): The proposal to delete the second supervisory decision in point 52 and transform it into a discretion for the Finnish competent authorities (see provision 139) would imply **the deletion of the mutual recognition clause**.

- with reference to point 53 (see provision 140): This national discretion allows a Member States to recognise the treatment by another Member State of certain leasing transactions concerning offices or other commercial premises situated in its territory, i.e. irrespective of whether or not the national discretion contained in point 53 is exercised in the Member State itself. When exercising this mutual recognition clause, the treatment by another Member State is recognised for such exposures in that Member State.

As the majority of Member States currently disclosing their national transposition of the mutual recognition clauses do exercise them and as the stock take does show strong willingness to recognise the national treatment of such exposures, it is proposed to turn the mutual recognition clauses in points 51 and 53 into **options for credit institutions**.

3. **Drafting Proposal:**

with reference to point 51: When the discretion contained in point 51 is exercised by the competent authorities of a Member State, credit institutions may assign a risk weight of 50% to such exposures fully and completely secured by mortgages on offices or other commercial premises.

with reference to point 52: delete the reference to point 52

with reference to point 53: When the discretion contained in point 53 is exercised by the competent authorities of a Member State, credit institutions may assign a risk weight of 50% to such exposures related to property leasing transactions concerning offices or other commercial premises.

142. Standardised Approach, Annex VI, Part 1, point 58 (Directive 2006/48/EC)

"Competent authorities may dispense with the condition contained in point 54(b) for exposures fully and completely secured by mortgages on commercial property which is situated within their territory, if they have evidence that a well-developed and long-established commercial real estate market is present in their territory with loss-rates which do not exceed the following limits:

(a) losses stemming from lending collateralised by commercial real estate property up to 50% of the market value (or where applicable and if lower 60% of the mortgage lending value (MLV)) do not exceed 0,3% of the outstanding loans collateralised by commercial real estate property in any given year; and

(b) overall losses stemming from lending collateralised by commercial real estate property must not exceed 0,5% of the outstanding loans collateralised by commercial real estate property in any given year".

Point 54(b): "the risk of the borrower must not materially depend upon the performance of the underlying property or project, but rather on the underlying capacity of the borrower to repay the debt from other sources. As such, repayment of the facility must not materially depend on any cash flow generated by the underlying property serving as collateral"

1. **Overview of exercise:** Based on data reported for the mutual recognition exercise, 7 Member States (23%) have exercised this national discretion and 22 Member States (73%) have not exercised it.

2. **Possible solution:** In qualifying exposures secured by mortgages on commercial property for a 50% risk weight, the competent authorities may waive from the required criteria the condition that the risk of the borrower should not materially depend on the performance of the underlying property if a well developed and long established market exists in the territory with sufficiently low loss rates to justify such treatment. In general only local supervisors are in a position to assess whether these preconditions are met in their local market to justify the application of the waiver. This national discretion is subject to an explicit mutual recognition clause (see provision 143). As this national discretion is rooted in local market conditions, it is proposed to **keep this discretion in the present form.** See provision 143 for the level playing field proposal.

3. **Drafting proposal:** No change necessary.

4. **Other remarks:** Competent authorities should fully disclose the manner of their exercise of this national discretion in the supervisory disclosure framework, if they do not do so already.

143. Standardised Approach, Annex VI, Part 1, point 60 (Directive 2006/48/EC)

"When the discretion contained in point 58 is exercised by the competent authorities of a Member State, the competent authorities of another Member State may allow their credit institutions to assign a risk weight of 50% to such exposures fully and completely secured by mortgages on commercial property".

1. **Overview of exercise:** Based on the information on mutual recognition included in the supervisory disclosure framework on national websites, 15 Member States have exercised this mutual recognition (1 on a case by case basis), and 1 Member State has not exercised this mutual recognition. CEBS's stock take of June 2007 indicated that 18 Member Sates will recognise other Member States' assessment in all cases, 6 only when the relative importance of the specific subsidiary in the total group is low and consolidated solvency is not eroded, and 4 only in other specific circumstances and *2* will not recognise it.

2. **Possible solution:** This national discretion allows Member States to recognise the treatment of certain exposures secured by mortgages on commercial property by another Member State. In general local supervisors are in a better position to assess whether the local market in its jurisdiction is well developed and long established enough and if loss rates are sufficiently low to justify the application of the waiver. Exercising this mutual recognition clause results in a risk weight of 50% if the respective Member States has exercised the national discretion in point 58 and a risk weight of 100% if it has not exercised the national discretion in its jurisdiction. [Example: a Member State that has not exercised the national discretion (risk weight = 100% for exposures secured by mortgages on local commercial property) recognises the reduced risk weight for exposures secured by mortgages on commercial property in another Member State that has exercised the national discretion.] As the majority of Member States currently disclosing their national transposition of this mutual recognition do exercise it and as the stock take does show strong willingness to recognise the national treatment of such exposures, it is proposed to turn this mutual recognition into a an **option for credit institutions**

3. **Drafting Proposal:**

When the discretion contained in point 58 is exercised by the competent authorities of a Member State, <u>credit institutions may</u> assign a risk weight of 50% to such exposures fully and completely secured by mortgages on commercial property.

144. Standardised Approach, Annex VI, Part 1, point 77(a) (Directive 2006/48/EC)
"Credit institutions may determine the risk weight for a CIU as set out in points 79 to 81, if the following eligibility criteria are met: (a) the CIU is managed by a company which is subject to supervision in a Member State or, subject to approval of the credit institution's competent authority, if: (i) the CIU is managed by a company which is subject to supervision that is considered equivalent to that laid down in Community law; and (ii) cooperation between competent authorities is sufficiently ensured"

1. **Possible solution:** In CEBS's view this provision **is not intended to be a national discretion, but a supervisory decision** as to whether all preconditions are fully met in the individual approval process (i.e. to be applied on a case by case basis). The provision should have been implemented by all Member States (the provision says "the competent authority may determine" and not the Member States) and also applied as such. The text from the Directive should be kept unchanged and the Member States that have not yet implemented this provision as a supervisory decision to be used on a case by case basis should be urged to do so as soon as

possible. The condition sub ii) cannot be given to credit institutions as they do not have the relevant information. As a result, it would be no use to give the option under (i) to the credit institutions, as the approval will be the same. The corresponding mutual recognition clause in provision 145 introduces the possibility of a joint assessment process to allow for a harmonised approach.

2. **Drafting proposal:** No change necessary at the CRD level, but the provision should be implemented as a supervisory decision at the national level.

145. Standardised Approach, Annex VI, Part 1, point 78 (Directive 2006/48/EC)
"If a competent authority approves a third country CIU as eligible, as set out in point 77(a), then a competent authority in another Member State may make use of this recognition without conducting its own assessment".

1. **Overview of exercise:** Based on the information on mutual recognition included in the supervisory disclosure framework on national websites, 13 Member States have exercised this mutual recognition (1 on a case by case basis), 3 Member States have not exercised this mutual recognition

2. **Possible solution:** This provision is not a national discretion but a mutual recognition clause. When the competent authorities of another Member State have already recognised a certain third country CIU as eligible, a Member State does not need to carry out its own recognition process which simplifies the recognition process of third country CIUs. The decision, whether to carry out their own recognition process or not has to be decided by the national authorities on a case by case basis. Even if all Member States exercise this mutual recognition this provision cannot be turned into general rule. The proposal is to **keep this mutual recognition clause in the present form**. However, the possibility of **a joint assessment process** involving all supervisors that wish to participate (similar to the ECAI recognition process) should be considered. The outcome of the joint assessment process could be a public list of eligible third country CIUs that would form a strong common basis on which national competent authorities would form their decisions.
3. **Drafting proposal:** No change necessary.

146. Standardised Approach, Article 81.1 (Directive 2006/48/EC)
"An external credit assessment may be used to determine the risk weight of an exposure in accordance with Article 80 only if the ECAI which provides it has been recognised as eligible for those purposes by the competent authorities ('an eligible ECAI' for the purposes of this Subsection)".

See provision 147.

147. Standardised Approach, Article 81.2 (Directive 2006/48/EC)

"Competent authorities shall recognise an ECAI as eligible for the purposes of Article 80 only if they are satisfied that its assessment methodology complies with the requirements of objectivity, independence, ongoing review and transparency, and that the resulting credit assessments meet the requirements of credibility and transparency. For those purposes, the competent authorities shall take into account the technical criteria set out in Annex VI, Part 2".

1. **Possible solution**: Provisions 146 and 147 are not a national discretion; they are **general provisions** saying that only the ratings of recognised ECAIs shall be used (No 146) and under which conditions an ECAI can be recognised as eligible by the competent authority (provision147). The corresponding indirect mutual recognition clause in provision 148 introduces the possibility of a joint assessment process by all supervisors to whom an application has been made to allow for a harmonised approach.

2. **Drafting proposal:** No change necessary.

148. Standardised Approach, Article 81.3 (Directive 2006/48/EC)

"If an ECAI has been recognised as eligible by the competent authorities of a Member State, the competent authorities of other Member States may recognise that ECAI as eligible without carrying out their own evaluation process".

1. **Overview of exercise:** Based on the mutual recognition data disclosed under the supervisory disclosure framework, 16 Member States have exercised this mutual recognition (2 on a case by case basis).

2. **Possible Solution:** This provision is not a national discretion but an **indirect recognition clause** that allows Member States to abstain from carrying out an evaluation process of their own which simplifies the recognition process of eligible ECAIs. When the competent authorities of another Member State have already recognised a certain ECAI as eligible, a Member State does not need to carry out its own evaluation process. The decision, whether to carry out their own evaluation process or not has to be decided by the national authorities on a case by case basis. Even if all Member States do exercise this mutual recognition, the discretion cannot be turned into general rule. The proposal is to **keep this indirect recognition clause in the present form**. It should be noted that there is in place an **EU joint assessment process,** in the context of the CEBS, where competent authorities to whom the ECAI has applied are invited to participate with the intention of reaching a consensus view that would provide a strong common basis on which national competent authorities would form their decisions.
3. **Drafting solution:** No change necessary.

149. Standardised Approach, Article 82.2 (Directive 2006/48/EC)

"When the competent authorities of a Member State have made a determination under paragraph 1, the competent authorities of other Member States may recognise that determination without carrying out their own determination process".

1. **Overview of exercise:** Based on the mutual recognition data disclosed under the supervisory disclosure framework, 16 Member States have exercised this mutual recognition (2 on a case by case basis).

2. **Possible solution:** This provision is not a national discretion but an indirect recognition clause. When the competent authorities of another Member State have mapped the credit assessments of an eligible ECAI to the credit quality steps set out in the CRD, a Member does not need to carry out its own determination process which simplifies the mapping process of eligible ECAIs. The decision, whether to carry out their own determination process or not has to be decided by the national authorities on a case by case basis. Even if all Member States do exercise this mutual recognition, the discretion cannot be turned into general rule and, since it concerns an individual evaluation of an institution, binding mutual recognition does not seem appropriate. It is proposed to **keep this indirect recognition clause in the present form**. It should be noted that is in place an **EU joint assessment process,** in the context of the CEBS, where competent authorities to whom the ECAI has applied are invited to participate with the intention of reaching a consensus view that would provide a strong common basis on which national competent authorities would form their decisions.

3. **Drafting solution:** No change necessary.

Area: Transitional provisions

150. Transitional provisions, Article 154.1, second paragraph (Directive 2006/48/EC)

"Competent authorities which do not exercise the discretion provided for in the first subparagraph in relation to exposures to counterparties situated in their territory may set a higher number of days for exposures to counterparties situated in the territories of other Member States, the competent authorities of which have exercised that discretion. The specific number shall fall within 90 days and such figures as the other competent authorities have set for exposures to such counterparties within their territory."

1. **Possible solution**: This provision allows competent authorities to apply mutual recognition of the transitional use of a different definition of past due (SA) as defined by national discretion 70. This clause determines the possibility of mutual recognition and therefore should not be treated as a separate national discretion but analysed in the conjunction with national discretion 70. Due to the short expiry date it is proposed to **keep this mutual recognition clause in the present form.** This is proposed for all transitional

national discretions which expire before the end of 2011, in view of time needed for any legislative process and the maximum (very short) remaining use of the provision thereafter.

2. **Drafting proposal:** No change is necessary. The provision should be deleted at the end of its validity.

151. Transitional provisions, Article 154.7, first two sentences (Directive 2006/48/EC)

"Until 31 December 2011, for corporate exposures, the competent authorities of each Member State may set the number of days past due that all credit institutions in its jurisdiction shall abide by under the definition of 'default' set out in Annex VII, Part 4, point 44 for exposures to such counterparts situated within this Member State. The specific number shall fall within 90 up to a figure of 180 days if local conditions make it appropriate."

1. **Possible solution**: This provision allows more permissive transitional treatment of past due items for corporate exposures (IRB). According to the views expressed by industry representatives, additional clarification on this discretion is necessary - to clarify that after the transition period there is no longer any exception to the 90 days past due and to clarify that banks with subsidiaries in the countries with longer past due periods have the choice on whether to use for these subsidiaries the home or the local past due definition. It should be noted that the current CRD text clearly indicates the expiration date of the provision, i.e. it will not be valid after 31 December 2011. This provision should be considered together with provision 152, given the short time before its expiry date it is proposed to **keep it in the present form.** This is proposed for all transitional national discretions which expire before the end of 2011 in view of time needed for any legislative process and the maximum (very short) remaining use of the provision thereafter.

2. **Drafting proposal:** No change is necessary. The provision should be deleted at the end of its validity.

152. Transitional provisions, Article 154.7, last sentence (Directive 2006/48/EC)

"For exposures to such counterparts situated in the territories of other Member States, the competent authorities shall set a number of days past due which is not higher than the number set by the competent authority of the respective Member State."

1. **Possible solution:** This provision allows mutual recognition of days past due for corporate exposures (IRB) as defined in provision 151.

2. **Drafting proposal:** No change is necessary. The provision should be deleted at the end of its validity. **See provision 151.**