ABI Associazione Bancaria Italiana

Position Paper on CP 18 - CEBS's technical advice to the European Commission on options and national discretions

August 2008

POSITION PAPER

Introduction and General Remarks

The Italian banking industry appreciates the CEBS initiative in setting out its preliminary views on the issues called for in the European Commission's Call for Advice on options and national discretions in the Capital Requirements Directive ('CRD').

The Italian Banking Association (ABI), in order to produce a banking industry position on the CEBS consultation paper (CP18) has collected the various points of view of its member banks and gathered a series of proposals concerning the aspects treated.

Based on the comments received and on the activity of interbank working groups, ABI has drafted the attached position paper, transmitted to the CEBS and to the Italian Supervisory Authorities.

ABI is supportive of all initiatives that will contribute to achieve further market integration and supervisory convergence and that reduces the supervisory burden of cross-border banks. Therefore, ABI welcomes the opportunity to respond to the CEBS consultation in relation to the options and national discretions included in the CRD.

Nevertheless, ABI believes that some improvements and adjustments are necessary to the proposed text. As required, we enclose hereunder our drafting proposals to some provisions.

Specific Remarks

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.

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.

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.

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 of the Member State in which the residential property is located.

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.

ABI proposal

ABI supports the first hypothesis proposed by CEBS, so that the national discretion with binding mutual recognition should be retained in the interest of creating a common level playing field. The competent authorities of the Member State where the residential property is located should decide about the applicability of the regulation since they have the best knowledge about local market conditions.

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.

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.

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.

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.

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.

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.

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.

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.

ABI proposal

We agree that this discretion is given to the supervisory authorities, rather than Member States. However, that does not solve the competitive distortions resulting from divergent application. CEBS states itself that this discretion will be applied to all institutions in the respective jurisdiction, i.e. it is not a supervisory case-by-case decision. In terms of a level playing field, we can only concur on a difference between 'across-the-board' decisions taken by the supervisory authorities, rather than Member States, where they are linked to a joint process between the authorities that encourages convergence. This is not the case here. **We therefore believe that the discretion should be deleted altogether.**

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.

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.

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.**

Drafting proposal:

Until [31 December 2014] 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.

ABI proposal

As we believe that Point 66 (ND 32) should be deleted, this Point should automatically also be removed from the CRD. In the case ND 32 should remain, we ask not change it at the CRD level (without introduction of a transitional period) or to transform the provision into a general rule.

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.

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

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.

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

Changes are necessary to move towards the implementation of this article as a general rule. The aim is to avoid huge amount of discussions among/with regulators.

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.

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.

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.

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.

ABI proposal

We agree that this provision should be understood as part of the IRB approval process. Clearly, the precondition of 'substantially strong' underwriting characteristics and other risks characteristics is also not an objective criterion. **Our preference would therefore be that the provision be entirely incorporated into the model approval process.**

The alternative option would in our view not be to retain the wording as it stands, but to reformulate it in line with the general approach of allowing the use of internal models: 'Institutions may generally assign preferential risk weights of 50% to exposures in category 1, and a 70% risk weight to exposures in category 2, where they can demonstrate to the competent authorities that this treatment is appropriate on the basis of the strengths of their underwriting characteristics and other risks characteristics'.

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.

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

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.**

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.

ABI proposal

The national discretion with the mutual recognition will create additional burden for cross border banking groups, therefore the proposal is to transform it into a general rule.

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).

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

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.**

Drafting proposal:

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

ABI proposal

ABI agrees on the proposal of deleting the discretionary part of the provision.

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.

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

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.

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

ABI proposal

Impact on business

We believe that national supervisory authorities must maintain their right to enlarge the list of eligible guarantors due to the continual evolution of the contract structures of personal guarantees that may differ in the national frameworks and the possible changes to the credit standing of the guarantors already listed.

With respect to risk mitigation techniques for insolvency, we highlight the absence of insurance policies on credits among the acceptable techniques for risk mitigation: these play a significant role in the type of risk management used in **factoring**. We underline that recourse to this technique for the transfer of risk associated with the debtors transferred is favoured by the fact that in both factoring and insurance the risk is accepted on portfolio logic, even though each unit in the aggregate is evaluated specifically. We believe that the evolution of the contract structures used, specifically on the matter of the effectiveness of the guarantee with respect to the insured party’s obligations, the modality and the times of the execution of the guarantee as well as the maximum limit of the policy, can render this risk mitigation technique acceptable with respect to the requirements set out for personal guarantees.

With respect to the dilution risk, the obligations assumed by the guarantor is not based on mitigating the risks of the principal debtor’s insolvency, but rather by mitigating the risk that the transferred debtor will not miss a payment for the outstanding debt due to the underlying commercial relationships, that is to say the supply of goods/services by the transferor. In this context, mitigating the risk of a missed payment by the debtor is reduced by the actions undertaken by the transferor (substituting goods/services, a discount being applied to the debtor purchaser, etc) whose effectiveness is not reflected by insolvency ratings. To this end, we believe that transferring companies with a rating even below the minimum level set out in the Directive, i.e. class 2 should fall within the range of eligible guarantors if the contractual structures attribute to the transferor the role of guarantor for dilution risk as is the case with Italy. Moreover we highlight that the

dilution risk involves different types of financial operations based on trade receivables: in light of an international comparison, these operations are different even at a national level, therefore the contractual structures of the guarantees may also be difficult to compare.

Drafting proposal

We propose maintaining national discretion under 41 and 45 of the current version.

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.

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

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.**

Drafting proposal: No change necessary.

ABI proposal

It would be preferable to delete the discretion in favour of country homogeneity avoiding market distortions.

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.

Impact on business: Some respondents perceive some degree of impact

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).

Drafting proposal:

[Until 31 December 2019,] the competent authorities of a Member State may allow for exposures of an institution to corporates situated in the Member State and having consolidated sales and consolidated assets of less than EUR 500 million the use of M as set out in point 12. 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.

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).

ABI proposal

It would be preferable to delete the discretion in favour of country homogeneity avoiding market distortions. In consideration of the current market practices, ABI agrees on a transition phase, even if shorter than proposed, for instance 5 years.

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.

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

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).

Drafting proposal:

Until 31 December 2019, competent 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. 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.

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.

ABI proposal

It would be preferable to delete the discretion in favour of country homogeneity avoiding market distortions. In consideration of the current market practices, ABI agrees on a transition phase, even if shorter than proposed, for instance 5 years.

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.

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

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.

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…")

ABI proposal

See comments on point 41.

Drafting proposal

We propose maintaining national discretion under 41 and 45 of the current version.

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.

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.

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.

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

ABI proposal

We agree that this provision requires a supervisory judgement that the equivalency adjustments made by institutions are considered appropriate. However, this judgement is already implicit in the requirement that credit institutions "demonstrate" to the authorities that this is the case. The second step must therefore be automatic in our view, as also set out in CEBS' general explanation of a supervisory decision that involves judgement, but no additional choice. I.e., when institutions are able to demonstrate the adequacy of the adjustments made, then

"competent authorities shall allow" flexibility in the application of the required data standards.

In addition, we agree with CEBS' consideration that this provision must be implemented in all MS.

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.

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.

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.

Drafting proposal: No change is necessary. The provision should be deleted at the end of its validity.

ABI proposal

To maintain an incentive in rating based approach and given the speed of IT changes and implementation and the acceleration in evolving credit processes, ABI deems that one year's use requirement, is acceptable, especially for IRB banks which are rolling out their rating systems. This option should remain after the prescribed expiry date and could change from national discretion to general rule.

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.

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.

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.

Drafting proposal: No change is necessary. The provision should be deleted at the end of its validity.

ABI proposal

Given the short expiration date, there is no need to modify it. At expiry, for the same reasons under 71, the country option could be converted in a general rule or into a supervisory option. In the last case the supervisory option should be extended to all the legal entities belonging to the same group under a home-host coordination, to avoid differences in banks of the same group located in different countries.

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.

Impact on business: Unlevel playing field and cross border considerations were mentioned among the factors having an impact on business.

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.**

Drafting proposal: No change is necessary. The provision should be deleted at the end of its validity.

ABI proposal

As the aforementioned discretion imply uneven playing field, the exemption should be granted to all European institutions ad therefore the national discretion canceled transforming it into a permanent general rule, and within a reasonably short period of time. Otherwise, besides biased competition, there could be paradoxes such as a shareholding held by a subsidiary is granted the exemption while it is not allowed at consolidated level. That is more relevant given the long expiration date.

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.

Impact on business: The majority of respondents did not indicate direct implications for their business.

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.

Drafting proposal: No change is necessary. The provision should be deleted at the end of its validity.

ABI proposal

The possibility to apply a different coefficient to the business line 'trading and sales', if a certain condition is met, should not be left to national discretion but should be applied consistently across the countries. In fact, the application of a preferential risk weigh of 15% to the business line 'trading and sales' only in some Member States would lead to different results in calculating TSA credit institutions capital requirement for operational risk – even considering the same gross income allocation – only as an effect of different geographical location.

77. Transitional, Annex VII, Part 4, Point 66, 71, 86 and 95 (Directive 2006/48/EC)

"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.

Impact on business: 9 Members indicated that eventually divergent exercise of the option may have an impact on their business.

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 length of observations and not data quality issues which are raised in national discretion number 46.

Drafting proposal:

(…) Subject to the approval of competent authorities, 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. (…)

ABI proposal

This represents a relevant option and ABI would like to see a transformation into a general rule. There are segments and products where the evolution of the market and the changes in credit processes are such to observe a break in historical time series; for this reason banks have to select appropriately the time span to sample data and this could bring to a reduction in historical spanning.

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.

Impact on business: The majority of respondents did not indicate direct implications for their business.

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.

Drafting proposal: No change is necessary. The provision should be deleted at the end of its validity.

ABI proposal

The possibility to apply a different coefficient to the business line 'trading and sales', if a certain condition is met, should not be left to national discretion but should be applied consistently across the countries. In fact, the application of a preferential risk weigh of 15% to the business line 'trading and sales' only in some Member States would lead to different results in calculating TSA credit institutions capital requirement for operational risk – even considering the same gross income allocation – only as an effect of different geographical location. This provision should be reviewed before its expiration.

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.

Impact on business: No respondent indicated direct implications for their business.

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.

Drafting proposal: No change is necessary. The provision should be deleted at the end of its validity.

ABI proposal

The possibility to apply a different coefficient to the business line 'trading and sales', if a certain condition is met, should not be left to national discretion but should be applied consistently across the countries. In fact, the application of a preferential risk weigh of 15% to the business line 'trading and sales' only in some Member States would lead to different results in calculating TSA credit institutions capital requirement for operational risk – even considering the same gross income allocation – only as an effect of different geographical location. This provision should be reviewed before its expiration.

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"

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.**

Drafting proposal: No change necessary.

ABI proposal

Considering the fact, that the existing different thresholds for the "reasonable level of risk" defined by the competent authorities for consolidation purposes are burdensome (in terms of high costs) especially for cross-border institutions, ABI suggests a mutual recognition for the different competent authorities thresholds for consolidation purposes.