

## EPFSF Briefing

### “CRD: understanding the changes – and why?”

In advance of the general CRD<sup>1</sup> review of 2012, the European Banking Committee has decided to make targeted changes to the CRD to address specific shortcomings of the current framework, as well as incorporate the results of the large exposures review. Some of the changes also relate to the ECOFIN Roadmap responding to the financial turmoil. Following work carried out by the Commission working group on the CRD as well as by CEBS, the Commission launched a public consultation on changes to the CRD which ran from mid-April to mid-June 2008. A recent addition to the package of proposals is the Commission's consultation on incremental risk in the trading book. It is proposed that the changes to the CRD will be adopted by October 2008 with a view to ratifying them under the current parliamentary legislature, i.e. by April 2009.

The Commission proposals will comprise two different legislative instruments: one co-decision procedure to amend the core rules of the CRD (Lamfalussy Level 1) and one comitology procedure to make technical changes to the CRD annexes – except Annex III of Directive 2006/48/EC - (Lamfalussy Level 2).

Amendments to the CRD are planned in six sections:

- Large exposures
- Hybrid capital instruments
- Supervisory arrangements
- Waivers for cooperative bank networks
- Technical amendments to Directive 2006/48/EC
- Technical amendments to Directive 2006/49/EC

#### **Large exposures**

The CRD provided for a review of the large exposures regime because it was not amended as part of the original CRD package and is 15 years old. The review covered such areas as the objective for the large exposures rules, divergent application across the EU, measurement of exposures, risk mitigation and reporting requirements.

CEBS outlined the purpose of a large exposures regime as being to protect against the risk of a regulated institution incurring traumatic loss (from an unforeseen event), likely to threaten its solvency, as a result of the failure of an individual clients or group of connected clients. Although a wide-ranging review was undertaken, the proposed changes mainly amend the existing regime (based on a hard limit of 25% of own funds in the banking book and capital charges in the trading book) and aim to simplify and harmonise the regime by deleting a number of national discretions and further aligning it with the solvency regime.

Inter-bank exposures with a maturity of less than one-year are currently exempted from the 25% limit. The Commission has proposed to remove this preferential treatment on the basis that contagion effects could cause failures of other connected institutions thus potentially creating systemic instability. The whole financial industry has repeatedly expressed concerns in relation to the negative impact this change could have on liquidity management and the interbank markets.

'Intra-group exposures' has also been a significant issue due to the numerous related national discretions and the growing number of cross-border banking groups in the EU. While the Commission initially suggested harmonising the treatment of intra-group exposures, it is expected that it will propose to retain one of the existing national discretions while awaiting its ongoing work on cross-border intra-group assets' transferability.

---

<sup>1</sup> The Capital Requirements Directive covers Directives 2006/48/EC (Article 156) and 2006/49/EC (Article 51).

### **Hybrid capital instruments**

The current framework does not provide rules for the recognition of hybrid capital instruments (instruments with characteristics of both equity and debt) as Tier 1 regulatory capital. Therefore national regulators implemented the 1998 Basel Agreement ('Sydney Press Release' - SPR) in an inconsistent manner, creating an unlevel playing field across the EU. Because of the importance of hybrid instruments as a major funding source for banks, the Commission suggested a common, principle-based approach regulation to implement the SPR in the EU.

The proposed rules duly reflect the three main eligibility criteria set out in the SPR: flexibility of payments, permanence and subordination. However, they do not define the loss absorption principle, which is presented as an additional eligibility criteria rather than the outcome of the three first ones. The proposed rules set clear limits for the recognition in Tier 1. It is key that the Commission maintains such a principle-based approach in order for local supervisors to be able to implement the directive in conformity with their respective corporate, fiscal and insolvency laws.

Financial industry requested the Commission to provide more clarifications on items eligible for recognition as Tier 1, and in particular for non-cumulative preferential shares. If too much discretion is left to Member States concerning items included in the definition of own funds or concerning items others than those established in the CRD to be included as deduction, it could hinder the harmonisation of supervisory practices and the levelling of the playing field among financial institutions.

### **Supervisory arrangements**

The refinements of the CRD in this area relate to the need to progress on supervisory convergence and in the implementation of a responsibility and accountability framework for the supervision of banking groups. Cooperation arrangements in both going concern and stress situations, and in particular the task of the consolidating supervisor, are currently not clearly defined in the CRD.

The Commission has proposed introducing, into the CRD, the concept of college of supervisors for cross-border banking groups, together with provisions on its composition, tasks and decision-making process. Colleges would enhance supervisory cooperation and information exchange thus avoiding duplication of work and rationalising supervisory reviews and assessment thereby increasing supervisory efficiency. Colleges already exist in practice; therefore this proposal represents a formalisation and potential extension of the terms of operation of colleges in the EU. However, few important financial groups operate solely in the EU, therefore any system introduced in the EU need to be capable of integrating into global supervisory arrangements, i.e. take account of third countries, without however interfering with the efficiency of any EU arrangement.

In terms of decision-making, while it is pretty clear that consensus-based joint decision would prevail, it is less clear how to proceed in cases when common decisions cannot be reached as regards Pillars II & III matters. Many representatives of the industry and to some extent the current thinking of the European Commission are supporting the "last say" of the home supervisor principle. There certainly is a role for CEBS to play here: in its policy-setting capacity, CEBS' advice to any of the parties during the decision-making process could facilitate ironing out possible disagreement among supervisors and reaching a joint decision; it should in any event be duly considered. CEBS would furthermore be referred to in the Directive to bring about convergence across colleges.

### **Securitisation**

The ECOFIN Roadmap for drawing the lessons from the crisis identified some issues relating to securitisation. The Commission has proposed changes in the CRD aimed at enhancing risk management practices, increasing banks' transparency on their transferred risks and complex instruments and addressing concerns about the incentives for lending banks in the securitisation process. Regarding incentives it has consulted twice on a proposal to require firms to retain 'skin in the game'. These consultations received overwhelming criticism from both industry and Member States on grounds of the negative economic impact this is likely to have on the EU, on damage to investors' ability to access markets, and that it will not achieve the Commission's own desired aims. The Basel Committee is also re-examining the Basel II securitisation framework and the industry has urged the EU authorities to make sure that any changes are global in nature and do not fragment capital markets at a time when confidence is most needed.

### **Incremental risk in the trading book**

The Commission has recently issued a detailed and technical consultation on incremental risk in the trading book and asked for comments by 15 October. This is purportedly in parallel with the Basel/IOSCO Committee work which has been underway via frequent dialogue with the industry for a number of years. It is important that Basel and IOSCO complete their work before the Commission proposes related CRD amendments to avoid the possibility of regulatory arbitrage between different jurisdictions and competitive implications for European industry. The proposals address the fact that Value at Risk models did not capture all the losses sustained in the trading book as a result of recent events and are intended to insert more extensively within the authorized internal model the credit and event risk dimension and to extend to 1-year the time horizon. These changes may significantly increase the capital requirement for trading book activities.

---

Briefing notes are prepared by the Financial Industry Committee to the European Parliamentary Financial Services Forum. For further information on the subjects raised in the briefs please contact the Chairman, Members or Secretariat of the Financial Industry Committee.

**Chairman Financial Industry Members**

Guido Ravoet, *EBF Secretary General*  
Rue Montoyer 10, B-1000 Brussels  
Tel: +32 2 508 37 11 / Fax: +32 2 502 13 30  
E-mail: [g.ravoet@ebf-fbe.eu](mailto:g.ravoet@ebf-fbe.eu)

**Secretariat**

Catherine Denis, *EPFSF Director*  
Rue Montoyer 10, B-1000 Brussels  
Tel: +32 2 514 68 00 / Fax: +32 2 514 69 00  
E-mail: [cdenis@epfsf.org](mailto:cdenis@epfsf.org)

**Steering Committee**

Zsolt László Becsey MEP  
Pervenche Berès MEP  
Jonathan Evans MEP  
Robert Goebbels MEP  
Sophie In't Veld MEP  
Piia-Noora Kauppi MEP  
Wolf Klinz MEP  
Astrid Lulling MEP  
Gay Mitchell MEP  
Alexander Radwan MEP  
Dariusz Kajetan Rosati MEP  
Manuel António Dos Santos MEP  
Peter Skinner MEP (SC Chair)  
Ieke van den Burg MEP

**Financial Industry Committee**

Alternative Investment Management Association (AIMA)  
Association of Mutual Insurers and Insurance Cooperatives in Europe (AMICE)  
Association of Private Client Investment Managers and Stockbrokers (APCIMS)  
AXA  
Banco Bilbao Vizcaya Argentaria  
Banco Santander  
Barclays  
BNP Paribas  
British Bankers' Association (BBA)  
Chartered Financial Analyst – Institute (CFA)  
Citigroup  
Commerzbank AG  
Deutsche Bank AG  
Deutsche Börse AG  
Euroclear  
Euronext  
European Association of Public Banks (EAPB)  
European Banking Federation (EBF)  
European Federation of Accountants (FEE)  
European Federation for Retirement Provision (EFRP)  
European Insurance and Reinsurance Federation (CEA)  
European Mortgage Federation (EMF)  
European Private Equity and Venture Capital Association (EVCA)  
European Savings Banks Group (ESBG)  
Federation of European Securities Exchanges (FESE)  
Fortis Bank  
Futures and Options Association (FOA)  
Goldman Sachs International  
ING  
International Capital Market Association (ICMA)  
International Swaps and Derivatives Association (ISDA)  
Intesa Sanpaolo  
JP Morgan  
Lloyds TSB  
Lloyd's  
London Investment Banking Association (LIBA)  
MasterCard Europe  
Merrill Lynch  
Nordea Bank Finland  
PayPal  
Prudential Plc  
Royal Bank of Scotland  
Securities Industry and Financial Markets Association (SIFMA)  
Société Générale  
Standard & Poors  
UBS AG  
UniCredit Group  
VISA Europe  
Western Union International Bank