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Deposit Guarantee Schemes: Commission prepares Communication for autumn 2006

The Commission's review of the Deposit Guarantee Schemes Directive (94/19/EC) is now at an advanced stage and discussions at the next EBC meeting mark the last step before the Commission prepares its Communication. Earlier discussions at the EBC on supervisory arrangements led the Commission to conclude that there is strong support to continue work on this issue but noted hesitations from some Member States about the potential for further harmonization.

A review of the current EU provisions governing Deposit Guarantee Schemes is necessary for a number of reasons:

- Directive 94/19/EC itself calls for a periodic review of the minimum coverage level;
- Cross-border mergers raise questions about current supervisory and financial stability arrangements between home and host countries
- The recent decision of a big Nordic market player to pool its home and cross-border activities under the European Company Statute has led to practical questions concerning the transfer of contributions to a scheme.

The Communication will rely on the extensive consultations which have been undertaken with stakeholders, Member States, the Committee of European Banking Supervisors (CEBS) and the European Forum of Deposit Insurers (EFDI). A synthesis of the results of the 2005 stakeholder consultation carried is available on the web page of the Directorate-General Internal Market and Services (available under http://ec.europa.eu/internal_market/bank/guarantee/index_en.htm). The Communication will also draw on two impact assessments carried out in collaboration with the Commission's Joint Research Centre (JRC). The first, concerning the €20.000 minimum coverage level, was discussed at the previous EBC meeting. The Commission's report http://ec.europa.eu/internal_market/bank/guarantee/index_en.htm concluded that a change at this stage in the minimum level was not a short-term priority. Further JRC work is being currently undertaken on the cost implications of potential changes to funding mechanisms, which involves a substantial data gathering exercise. Since the interim report is due in August 2006, its results will be fed into the Communication.

Adoption of the Communication is scheduled for autumn 2006. It will bring

More fundamental change to deposit guarantee schemes needs to be linked to progress in other areas of financial supervision...

The Commission will use the results of expert groups to consider possible measures...

together the results of the consultation process and of the quantitative assessments and policy conclusions will be presented about which steps might be taken in both the short and longer terms. The Communication will focus on two basic categories;

- Those issues which can be tackled immediately or in the very near future, preferably by non-legislative means.
- Those issues in need of a long-term solution, where the Communication will discuss under which preconditions such a solution would be feasible.

Consideration will also be given to whether a number of pragmatic issues would justify a new legislative text at this stage.

However, the review of Deposit Guarantee Schemes is tied in with other aspects surrounding financial supervision. As explained in the Commission's White Paper on financial market integration 2005-2010 and discussed in detail at previous EBC meetings, it is not possible to consider fundamental changes to Deposit Guarantee Schemes without addressing other fundamental issues concerning EU prudential arrangements. More fundamental changes to Deposit Guarantee Schemes will therefore need to be linked to progress made in these other key areas.

Mortgage Credit: Ongoing consultations to prepare the White Paper

The Commission has followed a coherent consultative process in the field of mortgage credit (a Mortgage Credit Forum Group reported in December 2004; a cost/benefit study was published in August 2005; and a Green Paper issued in July 2005 for public consultation). This process will continue in 2006: consultations will continue to be held with consumers, mortgage lenders, Member States and other stakeholders in order to ensure that any policy proposed is focused and will bring benefits to all stakeholders.

An Expert Group on Mortgage Funding has been established to consider barriers to all mortgage funding techniques and prioritise them in terms of their significance to the market. The Expert Group has also been asked to consider the most appropriate solution for each barrier. A dialogue between the EU mortgage lending industry and consumer associations has also been launched. The aim of the dialogue is reach a consensus on key consumer protection measures focussing primarily on the themes of information, advice, early repayment and annual percentage rate (APR).

The Commission will use the results of these Expert Groups to consider what, if any, measures, may be announced in its White Paper on the integration of EU mortgage credit markets to be published in 2007.

The Commission does not intend to rush towards legislative proposals in this field, hence the decision to postpone the White Paper to early 2007. Integration can be achieved through many means, and not just with

The review process has established a clear case to revise the Directive...

Consistency will be ensured through incorporation of specific provisions into the Payment Services Directive...

An unofficial text of the CRD is already available on the Commission's website....

directives. Consequently, all available options will be explored.

E-Money Directive: finalisation of the Evaluation

The Evaluation of the E-Money Directive (2000/46/EC) is nearing completion and a Commission Services Working Document containing recommendations will be published shortly on the Commission's website.

Publication of the report is the culmination of an extensive review process involving the conduct of an evaluation by external consultants (available under http://ec.europa.eu/internal_market/bank/e-money/index_en.htm#evaluation), a public stakeholder consultation, the submission of technical advice from the Committee of European Banking Supervisors (CEBS) as well as the organisation of a series of meetings with Member State experts and stakeholders.

The findings from this review process have confirmed the Commission services' initial impression that the E-Money Market has not evolved to the extent that had been forecast at the time of the Directive's adoption, and that the provisions of the Directive and their national implementation have partly contributed to this situation. The review process has thus established a clear cut case for the need to revise the Directive.

The report highlights a number of areas where the current provisions need to be adjusted: clarifying the scope and adjusting the core requirements. However it stops short of making concrete proposals in the absence of the necessary impact assessment – further work will need to be carried out before the Commission will be in a position to propose a set of new provisions which are judged proportionate to the risks posed by E-Money institutions.

In order to ensure full consistency with the currently negotiated Payment Services Directive, the report recommends that specific E-Money provisions should be incorporated into that Directive once it has been adopted by EP and Council.

Capital Requirements Directive: adoption and transposition

The CRD was signed in Strasbourg by the Council and the European Parliament on Wednesday 14 June. The formal date of adoption of the text will therefore be 14 June 2006. The recast (new version) of Directive 2000/12/EC will be numbered Directive 2006/48/EC while the recast of Directive 93/6/EEC will be numbered Directive 2006/49/EC. At http://ec.europa.eu/internal_market/bank/regcapital/index_en.htm#directive you can find the adopted, but not final, text.

The final publication in 19 languages of the text of both Directives in the

QIS5 indicates a reduction in the amount of Minimum Required Capital in line with supervisors' expectations...

Official Journal of the European Communities is scheduled for 30 June.

As at 23 June, the CRD Transposition Group has received 107 questions, most from supervisors. 61 answers have been published on the website thus far and a further set of 10 or so answers will be published shortly.

There are currently a small number of very technical questions where it is proving difficult to reach a consensus among CRDTG members on an agreed answer but where the Commission services remain nonetheless optimistic that consensus will be reached. The meetings planned for May and for July have been cancelled, as it was felt that there were insufficient issues to discuss which would justify holding a meeting.

QIS 5 and the Scaling Factor: Commission services propose "no change"

On June 16, CEBS sent the Commission services its final report based on a sample of 49 Group 1 and 213 Group 2 firms from 20 European countries (Group 1 firms fulfill all of the following three criteria: they are internationally active; they have a diversified business; they have original own funds in excess of €3 billion). The full CEBS report is available at <http://www.c-eps.org/documents/QIS5.pdf>.

The report shows that the minimum required capital (MRC) would decrease by **7.7%** and **15.4%** compared to that under the current regulatory framework for Group 1 and Group 2 firms respectively. These figures

- i) have been estimated after the application of the 1.06 scaling factor, i.e., the multiplier which was introduced in the CRD text after the QIS3 exercise conducted in 2003;
- ii) do not take into account transitional floors which will be applied until 2009 and are intended to limit the actual reduction in MRC levels and
- iii) represent the overall change of the MRC for credit, operational and market risks and
- iv) have been calculated under the "most likely approach", i.e., the approach that the firm is expected to use after implementation.

The main drivers for the decrease in the MRC are lower capital requirements for residential mortgage portfolios and other retail exposures, as well as corporate exposures.

The report also includes a specific analysis on credit institutions that provided data on at least two different approaches under the CRD. The outcome shows that on average the CRD does indeed provide an incentive to move to more sophisticated approaches in order to benefit from more risk sensitive regulatory calculations.

The report also stresses that both the data quality has improved since the previous exercise and that the overall results are affected by generally benign macroeconomic and credit conditions in the participating countries.

The report has been prepared in parallel with the G-10 document prepared by the BCBS. At its May meeting, the BCBS decided to keep the current calibration (i.e., the scaling factor has not been changed). The overall

results are consistent both with supervisors' expectations and with work carried on at G-10 level by the BCBS.

Given this, the Commission services do not propose to use Comitology procedure to change the current calibration of the CRD, i.e., not to change the 1.06 scaling factor included in the regulatory formulas being applied for calculating MRC under the IRB approaches. Nor do the Commission services propose to change any other part of the calibration of the capital framework.

Commodities

Article 48(2) of Directive 2006/49/EC requires the Commission services to consider an appropriate prudential regime for firms carrying out certain types of commodities derivatives business.

The Commission services are in the process of finalising a call for advice to CEBS on this issue. The call for advice will ask CEBS to look at prudential supervisory practice in this area at Member State level in the EU and in other markets. CBES will also be asked to produce an analysis of the prudential risks arising from this sort of business.

As part of their work, CEBS will need to consult with a broad variety of participants in these markets.

Regulatory Dialogues: New Dialogues launched

On 10 July, the regulatory dialogue between the US and the EU on financial services regulation will continue. During the meeting, parties will inform each other about their current legislative processes to be able to identify possible regulatory conflicts or frictions. In addition to discussing issues relating to insurance, securities and corporate governance, the agenda includes several banking regulatory areas such as Basel II implementation, financial conglomerates, banking M&A in Europe and minority investments.

In June 2006, new regulatory dialogues were launched with India (Dialogue on Financial Services Regulation) and Russia (Dialogue on Economic and Financial Issues). The EU-China Dialogue on Macroeconomic and Financial Regulatory Issues held its second meeting in May this year.

Revision of Article 16 of the Banking Directive: Commission proposal nearing adoption

The Commission's services are currently working on a proposal to

The Commission's proposal is scheduled for adoption before the Summer break...

Initial work is being conducted by CEBS in view of a report which will need to be submitted to the EP and Council...

considerably improve the legal certainty, clarity and transparency of the supervisory approval process with regard to acquisitions and increases of shareholdings in the banking, insurance and securities sectors.

After a careful consideration of the different alternatives following an extensive consultation process, the Commission's services believe that a legally binding solution is necessary in order to achieve the intended objectives.

The proposal would modify the existing framework with regard to both the procedure as well as the criteria for the prudential assessment. A clear and transparent notification procedure and criteria that are known up front would form the core of a harmonised application of the revised framework.

The proposal is scheduled for adoption before the Summer break.

Own Funds: rules under review

In June 2005, the Commission services asked CEBS for technical advice on the following topics:

- (i) A survey of the implementation of current rules on own funds across Member States;
- (ii) An analysis of the capital instruments recently created by industry;
- (iii) The development of guiding principles behind own funds;
- (iv) A quantitative analysis of the types of capital held by credit institutions within the Member States

On June 23, CEBS sent the Commission Services its final report on the first two items. It is available under: <http://www.c-ebs.org/Advice/advice.htm> . A suitable timetable for items iii) and iv) would be reviewed and further specified before the end of the year.

The report is consistent with the Commission's mandate, adequately detailed and comprehensive; it also describes some recent market developments on innovative capital instruments both in terms of the underlying economic characteristics and evaluation tools developed by rating agencies.

The work underway stems from the fact that the Capital Requirements Directive requires the European Commission to submit by 1 January 2009 at the latest, a proposal to the European Parliament and to the Council for any amendment needed to the Directive with a view to a common definition of own funds.

Large exposures: rules under review

Following the EBC meeting last November, a call for technical advice was issued to CEBS in early December 2005 in relation to the review of the existing rules on Large Exposures (LE). Specific technical advice from CEBS was sought in the following areas:

CEBS has already delivered two sets of technical advice....

- i) A stock-take of current supervisory practices
- ii) An industry consultation on current practices
- iii) An analysis of credit risk mitigation techniques and products used within the LE framework

The first piece of technical advice - a stock-take of supervisory practices - was originally requested for completion by March 31st 2006, but an extension was provided, and the technical advice was received at the end of April. It is available under: <http://www.c-ebs.org/Advice/advice.htm>

The second piece of technical advice - the industry consultation - was originally requested for completion by June 30th 2006. In response to requests from industry for an extension to the closing date, the Commission agreed to extend the original deadline by two months. CEBS will now deliver the results of the market survey at the end of August 2006. The industry questionnaire was posted on the CEBS website and was open for consultation until June 16th, and unless otherwise requested by respondents, the responses are available on the CEBS website under:

http://www.c-ebs.org/Advice/LE_response.htm

The final piece of specific technical advice requested, the work on credit risk mitigation, is also due for submission by CEBS at the end of August 2006.

Following the re-scheduling of the deadlines for the CEBS technical advice, a discussion paper will be distributed to the EBC Working group on Large Exposures (WGLE) within the next two weeks. Members that have not yet made a nomination to the EBC WGLE may do so through the EBC Secretariat.

The work underway stems from the fact that Directive 2006/48/EC requires the European Commission to submit by 31st December 2007 a report to the European Parliament and Council on the functioning of large exposures together with any appropriate proposals.

News in Brief:

- **Competition inquiry into the EU retail banking sector**

DG Competition is currently conducting a sector inquiry into retail banking which has two strands. On the first strand - **payment cards** - the interim report was published on 12 April. Public consultation on the report ended on 21 June. The draft report is available here:

http://ec.europa.eu/comm/competition/antitrust/others/sector_inquiries/financial_services/public_consultation.html.

The second strand of work concerns **current accounts and related services**; the bulk of retail banking activity. The interim report on this strand will be published in mid-July, also for public consultation.

A public hearing covering both strands of the retail banking inquiry will be held in Brussels on 17 July. Interested persons can register to attend this hearing and obtain further information here:



http://ec.europa.eu/comm/competition/antitrust/others/sector_inquiries/financial_services/

- **Agreement on Comitology**

Agreement has been reached between the European Parliament, Council and the Commission on Comitology further to long and complex negotiations. Under the new agreement, a new control procedure will apply to all "quasi legislative" measures (i.e. those modifying non-essential elements of legal texts adopted under co-decision). This deal also enables the removal of "sunset clauses" in a number of Directives (including the banking directive). A more detailed note on the implications of the new agreement in the field of banking will be addressed to EBC members in due course.