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Internal Market and Services DG
FINANCIAL INSTITUTIONS
Banking and financial conglomerates

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**Public consultation on possible changes to the Capital
Requirements Directive (2006/48/EC and 2006/49/EC)**

Feedback on responses received

Section 1 - Introduction

1. The Commission services launched a Public Consultation on changes to the Capital Requirements Directive on 16 April 2008. The comment period ran until 16 June 2008. The changes are a key part of the ECOFIN roadmap responding to the financial turbulence: the European Council has stated that they must be agreed by April 2009.
2. The responses to this consultation provide a useful basis for the finalisation of the Commission's proposal. By 18 June 2008, 121 responses were received from various stakeholders, including associations and participants in the financial services sector; originating in various member states. These responses will be published on the Commission services' website, except where confidentiality has been requested. The following table lays out the 'subjects' within the consultation that stakeholders have responded to:

121 Responses

	Large exposures	Hybrids	Supervisory Arrangements	Cooperative Bank Networks	Securitisation	Technical Changes
Response Subject	98	49	40	7	38	39

3. This Feedback Document is published to summarise a range of important issues in relation to which comments were made and to set out the Commission services' position on these issues having taken into account respondents' comments.
4. The comments received have been considered by the Commission services. In a number of areas, it is proposed to introduce changes to the draft proposals in light of the comments received. In other cases, after consideration, suggestions for change have not been accepted. In others, issues have been raised which remain subject to ongoing consideration.

Future process and timetable

5. Concerning the remaining process and timetable, it is intended to put the proposal forward for adoption in early autumn 2008. The proposals will comprise two comitology instruments and one co-decision instrument.
6. The Comitology proposals will be presented for approval to the European Banking Committee in September 2008 and thereafter will be submitted for scrutiny to the European Parliament; the intention of the Commission is to adopt the Comitology provisions by the end of 2008.
7. After formal adoption by the Commission in September 2008, the co-decision proposal will be considered by the European Parliament and the Council of Ministers under the 'co-decision' legislative procedure. It is expected that this legislative process can be completed by spring 2009.

Section 2 – Comments on Commission's draft proposal
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8. Responses received are in general terms supportive of the objectives of the Commission's draft proposals. In areas where respondents expect the proposals to create practical problems, amendments will be considered by the Commission to ensure that the attempt to strengthen the prudential framework does not create undue aberrations in financial markets.

Large Exposures

9. Overall, stakeholders have expressed their support for a vast majority of the suggested amendments. The feedback highlights that stakeholders particularly appreciated the simplification and harmonisation of the regime by removing a number of the current national discretions as well as the further alignment with the solvency regime, in particular in terms of the calculation of exposure values and recognition of credit risk mitigation techniques. This will result in a clear reduction in the administrative burden for the industry.
10. Nevertheless, the suggested tightening of the treatment of interbank exposures has clearly been a cause for concern for industry. The concerns have centred around the potential negative consequences on the ability of institutions to manage their liquidity and the impact on interbank markets. On this basis, a

number of stakeholders, while recognising that interbank exposures are not risk-free, argue that a removal of the current, widely-adopted exemption for exposures with less than 1 year maturity and thus applying a 25% limit on interbank exposures would not be desirable.

11. It has also been argued that exposures to institutions should enjoy preferential treatment as the prudential regulation, imposed on institutions, should provide sufficient comfort to the supervisors. Given that most interbank exposures take place in the context of liquidity management and are therefore short term, a number of institutions argued that a maturity dimension and/or application of a higher limit is needed. It has to be however noted that only a very limited number of these stakeholders provided more detailed information or comprehensive evidence justifying these arguments in a sufficiently robust manner or suggested alternative thresholds.
12. The earlier assumption that the costs and benefits of imposing limits on unsecured interbank exposures would vary significantly between banks and Member States has been confirmed:
 - a) The feedback provided by bigger institutions revealed that these institutions should not normally have significant difficulties to diversify or collateralise their exposures. Nevertheless, securing and diversifying the respective exposures might possibly give rise to additional costs¹. Few banks noted that the approach would have an impact on 'several large exposures', mainly those driven by derivatives counterparty exposures. They argued that this approach would worsen their competitive position on the derivatives market vis-à-vis the institutions operating in third countries. Finally, it is argued that in stressed conditions, the psychological effect of approaching the limit might be detrimental to market liquidity, increasing the fragility of banks and thus of the whole financial system.
 - b) The views of smaller and medium sized institutions appear to be split: On the one hand, part of the market segment representing smaller institutions welcomed the approach taken aimed at alleviating the disproportionately

¹ Only a very limited number of these stakeholders provided concrete evidence about the likely increase in costs.

restrictive impact and therefore supported the concept of a quantitative threshold². On the other hand, other smaller institutions together with medium sized institutions argued that the concept suggesting the introduction of a quantitative threshold would not work and that the amount of this threshold would have to be significantly higher than the range indicated above³.

13. Some specific requests have also been raised by certain stakeholders:

- The European Association of Co-operative Banks requested the retention of the exemption currently provided in Article 113(3)(n)⁴ as conditions for exemptions stipulated in Article 80(8) do not appear to cover all decentralised sectors sufficiently. In addition, co-operative banks also requested the extension of this exemption to exposures arising from participations or other holdings in entities within the respective network;
- Some institutions offering clearing and/or settlement services requested exemption of very short term exposures arising from operations related to the clearing and settlement of securities for clients, including exposures resulting from their clients' activity, as well as exemption of undrawn credit facilities that are offered by these institutions to facilitate the settlement and clearing of the respective transactions; and
- The European Association of Public Banks and Funding Agencies requested either to carve-out the exposures of state development banks to commercial banks from the limit or to subject them to a 20% risk weight (higher limit). It is argued that this measure would be necessary to avoid distortions of the specific business model of development banks, whose customer base primarily comprises of other (commercial) banks to which development funds in the form of credits are directed.

² Indicating that a threshold in the range of EUR [150-300 million] might be appropriate.

³ This appears to be a case in particular for institutions that operate in a relatively small market with a limited number of available counterparties, with only a limited integration with other entities outside this system (due to a wide range of reasons, including foreign exchange and credit risk aspects).

⁴ Exposures to institutions with which the lending credit institution is associated in a network in accordance with legal or statutory provisions and which are responsible, under those provisions, for cash-clearing operations within the network.

14. The Commission services have welcomed the debate on interbank exposures and, where appropriate, will consider incorporating some modifications to the suggested approach based on the specific request outlined above (in paragraph 13). Notwithstanding, as revealed by the analysis carried out, interbank exposures do pose a significant risk (in terms of negative externalities, moral hazard issues and systemic risk) as banks, although regulated, fail⁵. A failure of one institution can thus cause a failure of other institutions due to the contagion effect with the possibility of causing systemic crisis. For this reason, large interbank exposures require very prudent management, which is of particular importance for the soundness and stability of both the institutions and the whole financial system. In this respect, the purpose of the large exposures regime is - as a backstop regime- to protect against the risk of a regulated institution incurring traumatic loss, likely to threaten its solvency, as a result of the failure of an individual client or a group of connected clients due to the occurrence of unforeseen event(s). Ensuring that risks arising from large exposures to individual clients or group of connected clients (including institutions) are kept to an acceptable level follows from the overarching principles for prudential supervision, which are to ensure continued financial stability, maintain confidence in financial institutions and protect consumers and in particular depositors.
15. Against this background, the Commission services have very carefully weighed up the strengths of all the presented arguments and the outlined risks and, having reflected on the outcome of the analysis investigating the cost and benefits of several available regulatory approaches, have concluded there is a merit in pursuing the approach requiring a 25% limit to be applied on all interbank (unsecured) exposures regardless of their maturity⁶. In terms of the possible quantitative thresholds that would take account of the specific position of small banks, the Commission services have concluded that introducing such a threshold is unnecessary at this point in time and would not provide the correct mechanism for moderating the impact of the suggested approach to treat interbank exposures as any other exposures.

⁵ Which often requires official intervention leading to a considerable burden on taxpayers.

16. Regarding the treatment of intra-group exposures, a mix of views was gathered. While a number of stakeholders strongly supported the suggested approach, other stakeholders raised concerns/requested clarification regarding the possibility to meet the conditions in Article 80.7 and 80.8. Some respondents reasoned that there was a trade-off between achieving efficiency of supervision at group level and maintaining the soundness of individual group members. In this context, the ability to transfer assets from one entity to another was key.
17. In this respect, in the context of the ECOFIN Council roadmap on crisis management, the Commission services have been requested to carry out a feasibility study, by end 2009, that would identify (i) which concrete obstacles for asset transfers for financial groups exist (ii) how significant they are and (iii) what needs to be done to remove these obstacles in order to progress in the EU on the supervision of cross-border banking groups. So, against the provided feedback, as not to pre-empt the outcome of this analysis, the Commission services will consider suggesting in its proposal to maintain the current treatment of intra-group exposures as currently stipulated in Article 113(2). In addition, in order to ensure a consistent approach in the treatment of intra-group transactions/exposures in the solvency and large exposures regime, the Commission services will consider suggesting in their proposal to exempt exposures referred to in Article 80(7) and 80(8), provided that these exposures are also exempted in the solvency regime (i.e. those that would be assigned a 0% risk weight under Articles 78 to 83).
18. Several stakeholders raised concerns regarding the suggested extension of the definition of the 'group of connected clients'. These concerns centred on an additional administrative burden implied by the requirement to consider, in determining which clients represent a single risk, also the risks arising from the funding side.
19. In light of the recent market developments that have shown that two or more undertakings can be financially dependent (and pose significant risks) as they are funded by the same vehicle, the Commission services consider the

⁶ The present treatment of specific categories of banks and their exposures should also take account of many concerns raised in the consultation.

suggested clarification of the definition of the 'group of connected clients' justified and will thus consider pursuing this approach in its formal proposal. At the same time, the Commission services will consider introducing a recital clarifying that in determining the existence of a group of connected clients and thus exposures constituting a single risk, it is also important to take into account, among others, risks arising from a common source of significant funding provided by the institution itself, its financial group or its connected parties.

20. Several stakeholders expressed concerns about the suggested requirement in Article 106(3) to look-through to the underlying exposures in order to determine the existence of a group of connected clients. Stakeholders argued that such requirement would create considerable technical difficulties for banks and suggested adopting an optional approach to this issue. In this respect, the Commission services will consider adjusting the wording of this Article by clarifying that in order to determine the existence of a group of connected clients a credit institution shall assess the scheme, its underlying exposures, or both, while for this purpose, a credit institution shall evaluate the economic substance and the risks inherent in the structure of the transactions.
21. Some stakeholders also requested aligning the terminology in the solvency and large exposures regime in Article 115(1) that recognises a residential property as an eligible collateral for the large exposures regime provided that it is occupied or let by the owner (instead of the borrower). For the sake of reducing administrative burdens, the Commission services will consider amending this Article accordingly.
22. Some stakeholders also requested a partial or full exemption of exposures to Member State's regional governments and local authorities or guaranteed by such bodies if they would be assigned a 20% risk weight under Articles 78 to 83. The Commission services will consider in their proposal allowing Member States to exempt fully or partially to exempt these exposures accordingly.
23. Finally, some stakeholders also requested to maintain the current exemption for exposures arising from the undrawn credit facilities provided that an agreement has been concluded with the client or group of connected clients under which

the credit facility may be drawn only if it has been ascertained that it will not exceed the prescribed limit. The Commission services will consider adjusting their proposal accordingly, with the aim to expand the list of mandatory exemptions in Article 113 (1).

Hybrid Capital Instruments

24. The overall response has been largely supportive of many of the proposed changes to the CRD in respect of hybrid capital instruments. The principles-based approach included in the CRD suggested text has been welcomed and seen as a step in the right direction.
25. Many respondents however have not fully appreciated the interaction with CEBS' technical advice, i.e. that CEBS' advice needs to be properly taken into consideration, where appropriate, to make the principles included in the CRD operational. Respondents may not have understood that the principles proposed in the CRD will be made operational through CEBS' updated guidelines.
26. Some respondents have also questioned the proposed definition of "core capital" and in particular asked for clarity as to whether preference shares would be excluded from banks' core capital.
27. The Commission services would initially like to clarify that it is not appropriate to include, in principles based legislation, a specific list of instruments in EU level 1 legislation which, by its own nature, could not be complete and would need to be aligned to any future market developments.
28. Furthermore, the Commission services have identified an economic principle which would differentiate the core component of banks' capital from hybrid capital instruments. However, it has not changed the "starting point" of such assessment, which currently links the prudential regulation to the national definition of equity capital according to the accounting framework, in order to limit the possible impact on current domestic practices.
29. As a consequence, the suggested text identifies "core capital" as including those instruments which – irrespective of the legal terminology – (i) are included

- in the national definition of equity capital, (ii) fully absorb losses on a going concern basis and (iii) represent the most subordinated claim during liquidation.
30. In particular, these instruments should represent the "first line of defence" for any bank both during normal times and liquidation. In the majority of cases, they are represented by common shares and corresponding share premium but, more in general, by any type of instrument which gives no preferential right to holders in case of negative economic performance by the issuer.
 31. According to the suggested text, hybrids include those instruments which do not fulfil the above criteria, for example, preference shares (both cumulative and non-cumulative) which create preferential rights for both dividend payments and loss absorption.
 32. There has been significant support from industry participants for the introduction of dated instruments (subject to the supervisory suspension of redemption), supported by the reasoning that even share capital can be redeemable in certain circumstances and that the long dated maturity of such instruments is in line with US regulation and rating agency requirements which are well understood by investors.
 33. Some public authorities and institutions however expressed concerns with the eligibility of dated instruments since they do not comply with the "permanence" criterion, are not believed to be as conservative as undated instruments and as there is no developed market for such instruments in Europe.
 34. The Commission services intend to maintain this provision since the permanence criteria included in the Basel agreement would not refer to "perpetuity" but rather to "the availability" of funds. This position is also in line with current practices developed by US firms. Therefore, the suggested provisions which allow supervisors to suspend their redemption fully reflect similar provisions related to undated instruments and could address the concerns raised by some respondents.
 35. The Commission services are however aware of possible negative implications of this new option given to issuers, which includes the lack of a well-developed market and possible reputational risks associated with the possible suspension of redemption. To this end and consistent with the underlying rationale of

considering dated instruments as similar to undated instrument with an incentive to redeem at the expiration date, the Commission services confirm the proposal of including dated instruments up to the 15% limit (see below).

36. Consistent with similar clarification given by CEBS after the consultation on its draft advice, the Commission services would also like to confirm that instruments with a maturity equal to the life of the issuer will be considered undated for prudential purposes
37. A large proportion of respondents have concerns about the lack of clarity surrounding the eligibility criteria for hybrids related to loss absorption which refers to the objective of "not hindering recapitalisation". Many respondents believe that this principle is not needed and the operational mechanisms developed by CEBS may not work in practice, may be impossible to prove before the fact and may create an undue impact on the market. Other stakeholders would like CEBS to further clarify those operational mechanisms which would comply with that principle in time for banks to issue compliant instruments as soon as possible.
38. The Commission services believe that such a requirement is consistent with the ultimate objective of improving the quality of banks' capital. However, the Commission services do not see the need to clarify further the operational mechanisms to ensure adequate flexibility in the text.
39. There was also general endorsement for not introducing a quantitative limit which would have limited hybrids up to a percentage of the required amount of banks' original own funds.
40. Public authorities, on the other hand, favoured the introduction of the above limit suggested by CEBS, defined in terms of minimum capital requirements, since it would ensure higher quality of capital for less capitalised banks.
41. The Commission services acknowledge that, by not introducing that limit, the quality of capital for less capitalised banks may be affected. The Commission services however believe that the on-going supervisory review under "pillar 2" must play an important role in ensuring adequate quality of the capital base of those institutions.

42. The Commission services also believe that the combination of this type of limit with those defined in terms of total original own funds could have determined a more than proportional reduction ('cliff effects') of eligible hybrids for firms which experience a sudden deterioration in their economic performance.
43. The definition of the limit in terms of minimum required capital could also have prompted a more comprehensive discussion on the whole definition of regulatory capital. This has been rejected at this juncture, by the Commission services, due to the possible disagreement on the relevant calculating formula (e.g. treatment of participations held in financial intermediaries) and the absence of parallel work at the G-10 level.
44. Lastly, the application of the second limit would have determined limited impact to the current situations in particular in those members which already allow for such a high limit (50% of tier 1) for all types of hybrid instruments
45. Although there was general support for harmonised quantitative limits, respondents were eager to stress that the introduction of the conversion criterion for benefiting from the 50% limit could limit future hybrid issuances, in particular for those institutions which are not able to issue convertible instruments (e.g. cooperative banks).
46. A few respondents commented on the fact that Co-operative banks do not have instruments as referred to in Art. 57 (a), due to their specific governance structure and therefore could only benefit from the 35% limit.
47. The Commission services believes that the convertibility criterion ensures adequate conservatism in firms' capital base and may represent a reasonable balance between those member states which already allow for such a high limit and those which do not because of concerns on how those instruments actually behave during a crisis situation.
48. The above criterion could also introduce the incentive for the industry to develop hybrid instruments which would ensure higher quality capital during crisis (i.e. higher share of core capital). It would also reflect current market composition in terms of both investor bases and risk profiles clearly distinguishing between convertible vs. fixed-income instruments.

49. The 35% 'bucket' is intended to limit the possible impact in those member states which allow for higher limits for all instruments irrespective of the conversion criterion.
50. The Commission services has also taken the comments by the cooperative sector into due consideration and will duly reflect those concerns in its final proposal.
51. The respondents have generally supported a transitional provision due to the need to limit possible impact on financial markets, as well as disclosure requirements. As regards the latter, however, there are some who argue that this may create 'perception' problems as specific disclosure of 'grandfathered' instruments may be perceived as granting them a 'second class' status when compared to new issuance. The Commission services propose to maintain the provision to ensure transparency during the transitional period.
52. Respondents have also highlighted a number of drafting changes, in particular extending the number of call options beyond the solitary one currently proposed, as well as the need to refer to the applicable rather than to the 'national' tax regime for justifying an earlier redemption. These suggestions will be incorporated where possible.

Securitisation

53. The draft proposal aimed at:
 - a. enhancing the risk management practices of banks when acting as investors, sponsors or originators;
 - b. adjusting specific shortcomings of the provisions capital requirements for securitisation position and
 - c. addressing concerns over the incentives for lending banks to act prudently when granting loans even when the credit risk of the loans is in the end borne by investors in securitisations rather than by the lending bank itself.
54. The CRD changes consultation paper suggested that lending banks should hold capital for a certain percentage (15%) of the loans they have securitised, independent of whether or not they are actually exposed to the risk of the loans. This in particular takes away the incentive from banks to shed all risk from securitised loans to investors that the capital framework otherwise provides. As a consequence, banks may choose rather to retain some of the risk of the

securitised loans and thereby align their incentives with those of investors in their securitisations (this is hereinafter referred to as "the floor").

55. Furthermore, and as a qualitative draft requirement aiming to achieve the same result, the consultation paper suggested that banks should be required to apply the same due diligence in their lending decisions irrespective of whether or not they securitize the loans.
56. A number of correspondents from the industry are uncomfortable with any of the intended changes described above, at this stage, while analysis in Basel on lessons from the crisis is still ongoing. Some contributions explicitly ask for deferring these changes, while others only highlight the need for alignment with the Basel accord and could accept the changes, provided there is reasonable certainty that the same changes will be made in Basel. Notably, the caution against the changes on (a) and (b), with a few exceptions, did not refer to the substance of the changes. On substance, there was however also some positive feedback. Some industry associations estimated the impact of the changes of capital requirements (point a) to be small at present, which did not preclude that the changes would be setting the right incentives for future business. In this context, one Member State agreed with the spirit of the changes for liquidity facilities, but thought that in the specific case of eligible liquidity facilities under the Standardised Approach, the resulting capital requirement would be too high compared to capital requirements under the IRB approach.
57. In light of these comments, the Commission services believe it is appropriate to go ahead with the changes on (a) and (b). On substance, these changes were not called into question in material terms. On procedure, the Commission services are very comfortable that the proposed changes are fully in line with what is consensus already now among the Members of the Basel Committee, so that there is no procedural need to wait any longer with this limited set of important improvements.
58. Particular concerns have however been raised about what is referred to above as "the 15% floor". The correspondents believed that it introduces a capital requirement independent of risk, while otherwise, capital requirements were meant to be risk-sensitive. Consistently, doubts were voiced about whether this

would effectively address the conflict of interest between originators and investors as it is intended. In addition, there were concerns that such requirement penalises CRD-regulated originators as opposed to non-European originators and European non-bank originators. However, correspondents, almost unanimously, supported qualitative and disclosure requirements in order to achieve the desired alignment of investor and originator incentives.

59. In light of these arguments, the Commission services no longer propose to impose a 15% capital requirement on securitised assets. The Commission services will go forward with qualitative disclosure requirements to better align investor and originator interests. On the quantitative requirements, the Commission services will consider alternative arrangements to better align originator and investor interests and what incentives for originators and information requirements for investors should be included, if appropriate, in its proposal.

Significant Risk Transfer

60. Following discussions in the CRDWG, the Commission services have included a change in the consultation paper aimed at achieving convergence on the application of the so-called "significant risk transfer" criterion, a criterion that a bank has to meet when it securitises loans in order to obtain any regulatory capital relief from the securitisation. The Directive as it stands does not provide any guidance about what "significant risk transfer" means, and industry has consistently complained about level playing fields and administrative burdens caused by different interpretations of this criterion by different supervisors.
61. The solution that the Commission services suggested in their consultation paper consisted of two approaches from which banks could chose: a standardised test based on a fixed quantitative threshold, targeting mezzanine tranches, and a possibility to achieve recognition for significance of risk transfer on a case-by-case basis in a more flexible fashion working with the competent authority.
62. A number of correspondents appreciated the fact that the Commission services were seeking convergence and were trying to provide legal certainty for firms. However, in the view of some there was still too much flexibility for supervisory discretion built into the draft text. Some correspondents even suggested

dropping the significant risk transfer criterion altogether rather than trying to achieve convergence on its application, replacing it by a test of "commensurate" risk transfer. In principle, such a possibility exists in the current text as an alternative for banks to choose, however its application on a case-by-case basis was found to be impractical and burdensome in responses both from the industry and public authorities. A number of correspondents thought that a fixed threshold applied to the mezzanine tranches could be subject to arbitrage and not sensitive to risk. Others supported a standard test based on a fixed threshold. One Member State however recommended a different approach in this regard, requiring an overall 10% reduction of capital requirements after securitisation. Another Member State, one banking association and two individual firms expressly supported the mezzanine test but asked for deletion of the alternative based on 80% of the first loss in cases where there are no mezzanine tranches.

63. The Commission services are of the view that the responses confirm the need of progressing towards convergence in this matter. In light of the consultation, it has become clear that while a standardised test based on mezzanine tranches, like any standardised test, cannot be the most differentiated approach to the problem, the feedback also shows the need for a standardised test and that among different possibilities for designing such a standardised test, one based on the mezzanine tranches is still the most sensible approach. To enhance legal certainty, the wording could still be improved somewhat to define more clearly when the test is complied with. Those correspondents in favour of replacing the significant risk transfer criterion by one for commensurate risk transfer may be pointed to the more flexible alternative to work individually with competent authorities. The wording of this alternative will be further improved in light of concerns over the administrative burden that a case-by-case assessment imposes on both banks and supervisors.

Supervisory Arrangements

64. Overall, stakeholders expressed their support for an explicit reference to colleges of supervisors in the CRD as an important constituent of enhanced supervision. Views diverged as to the role of colleges in further enhancing the efficiency of group supervision.

Crisis management arrangements

65. Stakeholders broadly supported the suggested crisis management arrangements. In particular, representatives of the industry welcomed the reference of an 'EU mandate' for supervisors in terms of financial stability. Although some national authorities considered this amendment premature, too general or likely to undermine the legal certainty of decisions. In contrast, it has been suggested to further develop this 'EU mandate' in line with the 14th May ECOFIN conclusions.
66. Most stakeholders supported the role of colleges in crisis management which shall have regard to the work of other forums established in this area. Nevertheless, one respondent suggested - in the context of emergency situations – referring to the financial stability groups established by the May 2008 MoU on crisis management (Ministries of Finance, central banks and supervisors) instead of referring to colleges. It was also suggested to further enhance the information exchange between supervisors and central banks in going concern situations and in relation to third countries. One respondent suggested further reinforcing the right of information for supervisors of systemically relevant branches (e.g. communication of the assessment of a crisis).
67. In light of the comments received, the Commission services consider that the suggested amendments adequately underpin the 14th May ECOFIN MoU on financial stability, and agree that information exchange between central banks and supervisors in going concern situations could be further enhanced. These will be reflected in the proposal.

Determination of systemically relevant branches

68. The draft proposal requires competent authorities to assess the systemic relevance of branches if their market share, in terms of deposits, exceeds a certain percentage in a host Member State. The Commission services also carried out a survey on the significance of branches in host Member States. 24

Member States replied to the questionnaire of the Commission services⁷. This survey confirms that a 2% threshold seems appropriate.

69. The industry would favour a more flexible approach, based on a case by case analysis. Quantitative thresholds are considered too rigid, and not tailored to all possible local market conditions. Most representatives of the industry suggested assessing the significance of branches not only in reference to the host market, but also in relation to the banking group. From the industry perspective, there was support for the consolidating supervisor having the last say in determining which branch is systemically relevant. Other stakeholders emphasised that a quantitative threshold does not capture systemic risk arising from a large customer base (small deposits but a significant number of clients). Some respondents suggested making it clearer that a branch should not be assessed solely on the basis of quantitative criteria. To avoid unnecessary red tape, it has been suggested that the systemic relevance of branches, based on criteria, should only be assessed when the host Member State explicitly makes a request to the home competent authority.
70. Based on the above-mentioned survey, the Commission services hold the view that a quantitative threshold (2%) will provide clearer guidance for supervisors to consider which branch is systemically relevant. Nevertheless, the Commission services agree that criteria should not be rigid and used as an automatic trigger. The process for determining systemically relevant branches will be further clarified in that respect.
71. While most respondents agreed with the suggested amendments, some stressed that colleges only cater for situations where decisions on on-going supervision shall be taken, and that a credit institution with only systemically relevant branches does not lend itself to a 'collegial structures'. Some industry representatives echoed the concern that the development of such colleges could undermine the country-of-origin principle, while some authorities

⁷ There are 35 branches whose market shares in terms of deposits exceed 1% in a host MS, 14 branches exceeding 2%, 13 branches exceeding 3%, 8 branches exceeding 5% and 4 branches exceeding 10%. 9 MS do not have any branches below 1% in terms of deposits. 15 MS have branches above 1%, 9 MS with branches above 2%, 8 with branches above 3%, 4 with branches above 5%, and 3 MS with branches above 10%.

mentioned that host supervisors should receive information from branches if there is an urgent need for relevant information.

72. With respect to colleges for 'solo' credit institutions, the Commission services considers that the suggested amendments are sufficiently clear in stating that those arrangements shall not affect the right and responsibilities of competent authorities under this Directive.

Composition of colleges

73. Most respondents expressed support for colleges with a 'variable geometry' where the consolidating supervisor would decide which competent authority participates in a meeting/activity of a college. This would allow the consolidating supervisor to create efficient 'core colleges'. Some respondents suggested that the consolidating supervisor should be required to create an appropriate mechanism enabling other competent authorities to obtain information (e.g. reporting of a 'standing group' to the 'full college'). Other authorities argued that supervisors of subsidiaries and systemically relevant branches should have a right to the college membership. Some respondents suggested including in colleges all supervisors if the market share of a subsidiary or a branch accounts for more than 5 or 10% in the host Member State.
74. Most stakeholders emphasised that guidelines from CEBS were crucial to find pragmatic solutions to the operational functioning of colleges. In contrast, one respondent suggested defining significant and systemic relevant cross-border institutions for which colleges would be required and proposed laying down criteria to define 'core colleges'.
75. In light of those comments, the Commission services consider that CEBS' operational guidelines are best placed to deal with the detailed operational functioning of colleges. Provisions on colleges should be kept sufficiently flexible in the Directive text to cater for the specificities of different banking groups.

Interaction with third country supervisors

76. Some representatives of the industry emphasised that the draft proposal was unclear concerning how colleges chaired by the EU consolidating supervisor would interact with third country supervisor, especially where these may be the supervisor of a third country parented credit institution. It should be noted that

'international' colleges of supervisors could be set up as a result of the FSF recommendations. In that respect, some firms harbour concerns that the CRD would result in a parallel EU framework by requiring 'solo' credit institutions with systemic branches or EU parent credit institutions, the parent undertaking of which is a credit institution or a financial holding company with its head office in a third country, to implement EU-specific colleges. It was suggested having a clearer distinction between the EU concept of consolidating supervisor and the concept of colleges which may involve third countries.

77. The Commission services consider that colleges should not prevent the consolidating supervisor and third countries supervisors from further cooperation. The Directive text would specify that third countries' supervisors may participate in colleges, where appropriate.

Involvement of CEBS

78. On a general note, most stakeholders fully supported strengthening the role of CEBS by mentioning specific tasks and roles for the Level 3 Committee in the CRD.
79. Representatives of the industry emphasised that the main task of CEBS was to monitor the coherence and consistency of the activities across colleges, and should not directly interfere with day-to-day supervisory policies. CEBS' role should be ex post review and adherence to CEBS operational guidelines. According to some stakeholders (Member States and industry), this monitoring role should be cemented in the Directive together with a European mandate for supervisors. As regards the information to be passed on to CEBS by the consolidating supervisors, there was appetite to clarify the scope of information both in going concern and emergency situations. The reference to CEBS guidelines for the operational functioning of colleges was much appreciated by industry representatives as the development of colleges and the greater emphasis on consolidated supervision should go hand in hand with a reinforcement of CEBS' role.
80. Most respondents from the industry stressed that it was not appropriate to involve CEBS (as a mediation body) during the decision making process for Pillar 1 model validation, as the joint validation process has worked well so far.

In addition, supervisors expressed concerns that a mediation mechanism triggered by banks (as suggested in Article 129(3) along the lines of the Solvency II proposal) would come down to an 'automatic complaint' by market participants.

81. In view of the various comments, the Commission services are considering reviewing the mediation process to make it more effective. With respect to CEBS' role, the Commission services agree that the emphasis should be on a greater convergence across colleges.

Decision making process

82. The suggested approach not to change for the moment the allocation of responsibilities was fully supported by most supervisors and some extent by some industry representatives of smaller local banks, who noted that final decisions for supervisory issues should be taken by host supervisors who know local market conditions best. It was stressed that further changes to the allocation of responsibilities could not be contemplated as long as there is no cross-border "safety-net" for groups. In contrast, most representatives of the industry considered that the crisis management issue should not prevent the EU from establishing an efficient supervisory framework. In general terms, they suggested a step forward towards reinforcing the powers of the consolidating supervisor. It was emphasised that only a clear decision making process will allow colleges to function efficiently.
83. The draft proposal suggests an agreement between authorities on some key supervisory activities coupled with a non-binding mediation mechanism. While some stakeholders considered this proposal well-balanced, some industry representatives and Member States harboured concerns that the mediation mechanism in case of disagreement on some key supervisory decisions referred to in Article 129(3) (e.g. capital add-on on subsidiaries) will make the decision-making process difficult and burdensome while banks need decisions in a time-efficient manner. Drawing on the positive experience of Article 129(2), it was recommended that the consolidating supervisor should have the last say in case of disagreement for all supervisory decisions listed in Article 129(3), for Pillar 2 (supervisory review process and ICAAP) and for Pillar 3 (disclosure) issues. In addition, most industry representatives considered that seeking CEBS

advice would not justify extending the decision making process timeframe (which should be 6 months), and should in any case be coupled by a strong 'comply or explain' mechanism. The absence of a maximum timeframe to reach a decision could hamper efficient and prompt decisions. CEBS in its policy-setting capacity may nevertheless be requested, by any of the parties, to give its advice on a matter.

84. Most industry representatives considered Pillar 2 as a central process and thought it should be fully integrated in a planned, collegial supervisory process. Pillar 2 would best operate at the level of the group rather than the individual entity. According to one set of respondents representing cross border banks, the 'lead' supervisor would be the single contact point and would be the sole authority for all matters of prudential supervision at the level of the group and its constituents. On a less ambitious note, other respondents stressed that the list of activities to be dealt with in colleges should not be limited but kept open in the CRD text.
85. Some stakeholders suggested that the tasks of colleges could be more 'outcome'-oriented by referring, for example, to supervisory programmes based on a risk assessment of the group, a single reporting framework, the agreement on the adequacy of own funds within a group, or a report containing the assessment of the group, including early signs of emergency situations. In keeping with Commission services' objective of not changing responsibilities, it was suggested that the consolidated supervisor, in cooperation with host authorities, could have the last say in defining the adequacy of own funds for the group and its legal entities. Host supervisors would then take their own decision, after duly having considered this assessment.
86. Other stakeholders (Member States and Supervisors) considered that reaching an 'agreement' on some decisions and on delegation of tasks and responsibilities was at odds with the stated objective of not changing responsibilities, and should be dropped, or at least be drafted more clearly. It has been emphasised that the proposed amendments might unify the application of Directives within a banking group, but at the same time might result in further fragmentation across and within Member States. Colleges were seen as a facilitating tool for both the consolidating supervisor and the host

supervisor. Particular concerns were expressed regarding interbank exposures and the designation of significant subsidiaries in the absence of any guidance in EU legislation. While some authorities emphasised that the CRD should not focus too much on specific issues, other stakeholders stressed the importance for the Commission services to ensure consistency of legislation underlying the obligations in terms of disclosure requirements, reporting, Pillar 2 measures and the treatment of intra-group exposures.

87. One respondent requested Article 129(2) to be modified to allow the host supervisor to have the final decision for locally-developed models.
88. In view of the various comments and the fact that colleges should remain effective and efficient, the Commission services are considering whether the increased information flows and the mandate to consider the financial stability in other Member States should be accompanied by increasing the responsibility for certain decisions of the consolidating supervisor.

Waivers for banks affiliated to a central institution

89. Most respondents did not express any view on the proposed extension of the waivers provided for in Article 3. There were eight responses that commented on this subject; most of which expressed a neutral view. The representatives of the cooperative banks sector and the credit unions supported the proposed extension as it would increase level playing field. One Member State expressed support. One respondent objected to the extension of the waivers because, in its view, it would increase the competitive advantage of cooperative banks. The representatives of commercial banks supported the extension of the waivers but pointed out that the conditions for their application should be further specified.
90. Since this amendment seems to be generally accepted and supported by the directly interested stakeholders, the Commission services plan to maintain the text in the proposal. The Commission services do not consider it necessary to further specify the conditions for the application of the waivers as there is no evidence of the existence of problems in this respect.

Technical changes

91. Stakeholders generally welcomed the technical changes to Directives 2006/48/EC and 2006/49/EC, mainly based on the work of the CRDTG. They provided further drafting clarification (e.g. calculation of the relevant indicator for operational risk, treatment of leasing, reference to operational risk other risk transfer for disclosure purposes). Representatives of the industry welcomed further comitology measures in 2008/2009 to significantly reduce the number of options and discretions after CEBS technical advice. For options which are not subject to comitology measures, the industry asked for measures before the general review of 2012.
92. Some respondents from the industry considered that the following technical changes would not represent a sufficient improvement:
 - a) The treatment of CIU under Article 87(11) and Article 87(12) would not enable equity exposures to be handled in a risk sensitive manner, and scaling factors were considered too penal since a factor of 2 would exaggerate the risk associated with unrated exposures and exposures with the second lowest rating. Instead, a factor of 1.5 was suggested. In contrast, one Member State stressed that the suggested scaling factors were not sufficiently prudent.
 - b) As to life insurance policies, some industry representatives asked for a reduction in risk weights while other authorities emphasised the alleviation of prudential requirements and the need to develop an alternative treatment. One Member State stressed that the amendments were not located at the correct place within Annex VIII to maintain the treatment as a guarantee.
 - c) Regarding the treatment of short term exposures to institutions, industry representatives called for an extension of the preferential treatment to the central government risk weighted method. The suggested changes only aim at providing a clear framework across the Directive.
93. Some industry representatives asked for an extension of the transitional period for the treatment of incremental default risk given the current work at Basel regarding 'event' risk.

94. It was stressed that the purpose of using the exposure value before the application of the appropriate conversion factor or percentage was not clear. Some stakeholders considered that the proposal - by referring to a 100% conversion factor - would not allow firms to apply the relevant credit conversion factor.
95. The following concerns were voiced by some Member States:
- a) The proposal of an additional business line for AMA firms was not compliant with Basel II rules, and could cause difficulties for banks moving to AMA.
 - b) The proposed recognition of the double protection function of credit derivatives would still be incomplete. This function was fulfilled as well by credit derivatives included in the trading book and purchased as credit protection not against a non-trading book exposure but against a trading book exposures or a CCR exposure.
 - c) Regarding the treatment of first-to-default credit derivatives, it was stressed that specific risk could only be offset for one entity.
96. In light of the responses received, the Commission services believe it is best to leave the substance of the draft texts unchanged. The Commission services note that the final advice from CEBS on national options and discretions will not be available in time for it to be part of the current legislative package. The treatments envisaged for CIUs and life insurance policies appear on the one hand to constitute very well balanced approaches in light of responses from the industry and on the other hand prudential concerns raised, previously, by competent authorities. The Commission services however agree with one response that it is a good idea to align the treatment with that for guarantees and incorporate the possibility of a currency mismatch adjustment. The requested change on short-term interbank exposures however is unsuitable as it would constitute an inappropriate change of the existing treatment; whereas the currently envisaged changes in this area are a mere clarification of the existing treatment.
97. The Commission services believe that the transitional period for the market risk models does not have to be extended as the new requirements on event risk

may be expected to be in force by the beginning of 2010 when the transitional period elapses. On the other issues mentioned above, where correspondents sought clarification and improvements to the wording, the Commission services have exercised due care in revisiting the wording and clarifying it as and where appropriate.

98. Although this document is a review of the feedback received to the consultation and provides elements under consideration by the Commission services, it does not constitute any binding commitment on the part of the Commission services to revise the draft proposal accordingly nor does it limit the Commission services to making changes over and above what is laid out in this Feedback document.