COMMISSION SERVICES STAFF WORKING DOCUMENT

POSSIBLE FURTHER CHANGES TO THE CAPITAL REQUIREMENTS DIRECTIVE

INTRODUCTION

This Commission Services Staff Working Document seeks views on further possible changes to Directives 2006/48/EC and 2006/49/EC ('the Capital Requirements Directive', 'CRD'). These changes will supplement the two sets of revisions that have already been adopted or proposed: that is, the amendments that agreed by Member States and the European Parliament in April 2009, and the proposal adopted by the Commission on 13th July.

The possible changes set out in this document deliver commitments made by the Commission in its Communication of 4th March for the Spring European Council, which included undertakings to mitigate excessive procyclicality through counter-cyclical provisioning; to work on measures supplementary to the risk-based requirements of the CRD to address leverage or liquidity risk; to explore measures to ensure responsible lending and borrowing; and to remove the exceptions, derogations and discretions which give rise to differences in national implementing legislation from the current directives.

This document is organised in sections which discuss possible changes in four areas, accompanied by Annexes setting out suggested provisions to achieve the objectives discussed:

- Section 1 and Annex 1: through-the-cycle expected loss provisioning;
- Section 2 and Annex 2: specific incremental capital requirements for residential mortgages denominated in a foreign currency;
- Section 3 and Annex 3: removal of national options and discretions in the CRD;
- Section 4 and Annex 4: simplification of the Bank Branch Accounts Directive (89/117/EEC).

The Sections also contain specific questions on areas where the Commission Services would particularly welcome views. The questions are summarised in Section 5.

The suggested legislative amendments set out in the Annex are intended to provide a basis for consultation for the purposes of this Commission Services Staff Working Document. They are an exploratory draft, and are without prejudice to the contents of any formal proposal adopted by the Commission.

It is envisaged that the Commission will publish a proposal for a Directive dealing with some or all of the areas discussed in this document in October 2009. Any such proposal will be developed in the light both of responses to this document, and an impact assessment examining the anticipated effects of options for achieving the policy objectives discussed here.

FUTURE CONSULTATION ON LEVERAGE RATIO

As announced in its Communication of 4 March 2009, the Commission also intends to present a legislative proposal to restrain excessive and unsustainable balance sheet growth through a leverage ratio measure. It is anticipated that such a proposal will be finalised soon. The Commission intends to carry out a public consultation and impact assessment as soon as the main contours of its proposal are available. In parallel, similar work, in which the Commission is involved, is being undertaken by the Basel Committee on Banking Supervision.

AGGREGATE IMPACT OF AMENDMENTS TO CRD

However, as indicated above, these possible changes would follow other changes to the CRD contained in Commission proposal adopted on 13th July.[1] That draft directive proposes changes to the capital requirements for the trading book and for re-securitisations which are likely to increase significantly the levels of capital that banks are required to hold under those provisions. The possible provisions discussed in this document concerning non-risk based supplementary measures, capital requirements for residential and commercial real estate (including specific provisions for mortgages denominated in a foreign currency) and through-the-cycle expected loss provisioning would also represent a quantitative increase in regulatory capital, or would require institutions to commit resources to expected loss provisioning.

The Commission Services recognise that the cumulative effect of these various provisions might be substantial, and could have implications for the amounts of funds that banks have available to lend to businesses. It may therefore be appropriate – in addition to the impact assessments that have been or will be carried out in connection with each set of proposed amendments – to assess separately the aggregate effect of the proposed revisions to capital requirements and their potential impact on financial recovery and the 'real economy'. One purpose of such an exercise would be to assess whether the application of any of the proposed revisions should be postponed until recovery is advanced and assured. This would be consistent with Declaration by the G20 Leaders on Strengthening the Financial System made at the meeting in London on 2nd April 2009, which stated that prudential regulatory standards should be strengthened *once recovery is assured*, and that "*until recovery is assured the international standard for the minimum level of capital should remained unchanged*".

Question 1: What impact would the changes proposed in each section of this paper have on your activities or activities of firms in your jurisdiction, including costs linked to increase in regulatory capital and any other compliance costs?

Question 2: Do you have any views about any aggregate impact of the proposed changes to capital requirements?

Question 3: What is the optimal timing for these measures? Should their application be sequenced?

The Commission Services welcome responses to the policy objectives and the questions raised in this paper by **4 September 2009**. Responses should be sent to the following email address: markt-h1@ec.europa.eu

[1] http://ec.europa.eu/internal_market/bank/regcapital/index_en.htm

Responses will be published on the following website unless requested otherwise: http://ec.europa.eu/internal_market/credit_institution/regcapital/index_en.htm

SECTION 1

THROUGH-THE-CYCLE EXPECTED LOSS PROVISIONING ('DYNAMIC PROVISIONING')

3.1 INTRODUCTION

In keeping with the conclusions of the G20 and the ECOFIN,[2] the Commission services suggest introducing a methodology of through-the-cycle expected loss provisioning for credit risks on debt instruments in relation to certain exposures included in the credit institutions' banking book.

3.2 A COUNTER-CYCLICAL MEASURE FOR CAPTURING EXPECTED LOSSES

In order to stabilize bank capital and earnings over time, credit institutions should, in line with the ECOFIN conclusions on pro-cyclicality, build up through-the-cycle expected loss provisions for credit risks during good times (when relatively more loans are granted) and use these provisions during a downturn to cover (some) of the incurred losses. Through-the-cycle expected loss provisioning is essentially a countercyclical measure for timely capturing *expected* losses due to inherent credit risks that have not yet materialised as 'incurred' losses. The through the cycle provisioning should be applied to items on the balance sheet (such as loans) and possibly to off-balance sheet items (such as guarantees). It is different from countercyclical regulatory capital approaches that basically provide a capital buffer for *unexpected* losses. Methodologies for building up capital buffers are currently analysed in international fora, and the Commission will report to the Parliament and the Council on those additional counter-cyclical measures by end 2009 at the latest in accordance with Article 156 of Directive 2006/48/EC.[3]

The Commission services believe that a robust and effective sound through-the-cycle expected loss provisioning methodology should meet the following standards:

- it should be formula driven and largely non-discretionary;

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[2] ECOFIN conclusions on pro-cyclicality / July 6, 2009: The Council AGREES that the absence of counter-cyclical buffers and the lack of flexibility of accounting rules in allowing for through-the-cycle provisioning have been important factors in the amplification of the financial crisis. The Council UNDERSCORES the urgency and importance of addressing these issues.
The Council SUPPORTS the introduction of forward looking provisioning, which consists in constituting provisions deducted from profits in good times for expected losses on loan portfolios, and which would contribute to limiting pro-cyclicality (including the development of models for dynamic provisioning). Accounting standards, such as IFRS, currently do not allow for the recognition of expected losses. The IASB will publish an exposure draft dealing with the provisioning issue, including consideration of an expected loss model, by October 2009. Allowing for the recognition of expected losses would ensure the build up of provisions in good times, which can be used in downturns; would contribute to a better assessment of real profits in good times; adjust managerial incentives in relation to remuneration make investors more aware of the underlying risks and further enhance consistency between accounting and prudential rules. In line with the recommendations of the G-20 London Summit and calls from banking supervisors and the FSB to standard setters, the Council therefore CONSIDERS that standard setters should give priority to amending current accounting rules and allowing for more flexibility for provisioning expected losses.

[3] As amended by the review of the CRD that the European Parliament voted on the 6th of May 2009.

- it should be based on agreed rules and automatic triggers for the building up and use of the through-the-cycle expected loss provision;
- it should allow through-the-cycle expected loss provisions to have a material size in relation to the exposure classes (i.e. no specific cap);
- it should not allow the through-the-cycle expected loss provision to count as regulatory capital / own funds;
- it should have countercyclical factors based on a common EU methodology.

The objective of through-the-cycle expected loss provisioning and the general principles governing its calculation are outlined in Annex 3 (Draft recital and Draft Article 74a).

Since through-the-cycle expected loss provisioning refers to *expected* credit losses the Commission services conclude that these should not count towards regulatory capital which conceptually is a buffer for *unexpected* losses. Moreover the working assumption is that such a prudential measure would in parallel become acceptable under international accounting standards,[4] and would be built up "above the line" and would therefore have an impact on accounting profit. The Commission services stress their intention not to prejudge any decisions of the international accounting standard setter.

3.3 METHODOLOGY FOR CALCULATING THE THROUGH-THE-CYCLE EXPECTED LOSS PROVISION

The best example of through-the-cycle expected loss provisioning is provided by Spain, which already has a system of dynamic provisioning in place. This system has allowed Spanish banks to reverse in a downturn provisions they had been required to build up during a period of credit expansion.

The Spanish system of through-the-cycle expected loss provisioning, that is described in Annex under option 1 of Annex IXb, incorporates two coefficients (α and β) that reflect the historical average estimate of the credit loss for each risk category (α), applied to the increased amount in the loan portfolio and the historical average specific provision for each risk category (β), applied to the total loan portfolio. However, since the IASB might change the current incurred loss model into an expected cash flow model, the α factor may become redundant. Therefore, a simplified approach is provided under Method 2 of Annex IXb of the CRD (set out in Annex 3 to this paper).

As part of this public consultation, further consideration needs to be given as to the scope of exposure subject to through-the-cycle expected loss provisions. In accordance with some existing accounting standards, only on balance sheet items – as opposed to off-balance sheet items - are subject to impairment. Assets included in the non-banking book and/or measured at fair value will not be subject to through-the-cycle expected loss provisioning.

Credit institutions would be expected to apply countercyclical factors (β) to the value adjusted amount of each exposure class as at the reporting date. The through-the-cycle expected loss provision for a class of exposures would then be defined as the total amount

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4 The IASB has announced that it will publish an exposure draft dealing with the provisioning issue, including consideration of an expected loss model in October 2009

of exposures at the end of the period multiplied by the countercyclical factor β, minus impairment and provisions determined under the relevant accounting standards.

It is suggested that the Beta factor should be applied to different specific classes of debt instruments (exposure classes) and should be further calibrated within each asset/exposure class for risks by using risk weights. For this purpose, it is suggested to use the exposure class definitions of CRD Article 86 (1) with the exception of equity exposures under point (e) of that provision. This includes claims on governments and central banks, institutions, corporates, retail claims, securitisation positions in so far these are subject to an impairment test for accounting purposes. The Commission services suggest that Beta factors should not only be determined for exposures classes but further refined by taking into account specific risk characteristics of the debt instruments.

The Commission services suggest that the competent authorities of each Member State would develop the relevant countercyclical factor for non trading book (i.e. banking book) debt securities relating to borrowers located in their jurisdiction. Through-the-cycle expected loss provisions would apply both at individual level and at consolidated level. Determination of the countercyclical factors by national competent authorities is important because, at any given point in time, different Member States may be at different points of an economic cycle. However, the methodology for determining the countercyclical factor should be based on a common methodology developed by CEBS or the European Supervisory Authority. As a minimum, the methodology should be based on data on the incidence of loan-losses across a complete economic cycle.

Transparency underpins market discipline and helps investors and deposit holders to properly protect their interest in credit institutions. The Commission services therefore suggest amending Annex XII on disclosure. Suggested provisions to this effect are set out in Annex 3.

3.4 QUESTIONS

Question 4: The Commission services suggest that the through-the-cycle value adjustment should not count as regulatory capital (see ANNEX 1, suggested amendment to Article 57). Do you agree?

Question 5: Should off-balance sheet items be captured under the formula for through-the-cycle expected loss provisioning, given that 'provisions' for off-balance sheet items are not recognised in all relevant accounting standards? Should only assets subject to an impairment test be subject to through-the-cycle expected loss provisioning? (See ANNEX 1, suggested Article 74a (2).)

Question 6: At this point, the suggestion is not to include the option for competent authorities to allow internal methods to determine expected losses across an economic cycle. As an alternative to the regulatory approach to calculate counter-cyclical factors, would it be desirable to allow firms' internal methodologies (to be validated by supervisors)?

Question 7: Should the exposure class of Article 86 (i.e. for credit institutions subject to the IRB approach) be used irrespective of the fact that the credit institution may be under the Standardised approach? It may be noted that a mapping between exposures class under the Standardised approach and under the IRB is already used in the prudential reporting system of some Member States. As an alternative, should countercyclical parameters be defined for the 16 exposures classes under the Standardised approach? (See ANNEX 1, suggested Article 74a (1).)

Question 8: Please give your views on the following approaches:

1) the Spanish model of through-the-cycle expected loss provisioning;

2) a 'simplified' Spanish model.

In particular, we would welcome views on the relative merits of both options in terms of the building up of provisions in a graduated manner over time (See ANNEX 1, suggested Annex IXb).

Question 9: Should new risk categories (as suggested above) be introduced along the lines of the Spanish system or, alternatively, should the current risk categories of the CRD (e.g. credit quality steps in Annex VI) be used? (See ANNEX 1, suggested Annex IXb.)

Question 10: Is the 'location of the borrower' (as opposed to the booking of the exposure) the right approach, with a view to avoiding regulatory arbitrage? (See ANNEX 1, suggested Annex IXb 2.)

Question 11: Will the data to determine counter-cyclical factors be easily available?

Question 12: Please give your views on the methodologies for calculating the through-the-cycle expected loss provisions at consolidated level. (See ANNEX 1, amended Article 73.)

Question 13: Please give your views on the scope of disclosure requirements for through-the-cycle expected loss provisioning. (See ANNEX 1, suggested amendment to Annex XII (17).)

SECTION 2

RESIDENTIAL MORTGAGES DENOMINATED IN A FOREIGN CURRENCY

2.1 INTRODUCTION

In its Communication to the Spring European Council Driving European Recovery of 4 March 2009,[5] the European Commission announced it would come forward with a range of measures on responsible lending and borrowing. This will include an appropriate framework on credit intermediation, as one element of a package aimed at delivering responsible and reliable markets and for restoring consumer confidence.

However, foreign currency denominated loans to finance residential real estate are a particular concern because they have the potential to expose private households to foreign exchange risk and refinancing risk to a dangerous extent. This is a particular concern in relation to housing loans because these loans usually are well in excess of households' liquid assets and may constitute a large portion of the value of the residential property being financed.

2.2 POLICY OBJECTIVES

Historically, non-binding guidelines on lending have, in buoyant and liquid markets, failed to control lenders' excesses. Given the failure of guidelines or other 'soft law' approaches, it is now appropriate to consider specific and penal capital requirements to discourage credit institutions throughout the credit cycle from granting foreign currency loans to private households. This is especially the case where such loans exceed a low and conservative ratio of value of the loan to value of the property and where the private household does not hedge the foreign exchange risk or possess a stable and sustainable source of sufficient and freely available income denominated in the relevant foreign currency which is deemed by a credit institution following appropriate stress tests to service the foreign currency borrowing on an ongoing basis.

To address such risks, the Commission is considering imposing additional and specific capital requirements for loans for residential property that are denominated in a currency other than that of the income of the borrower.

Those additional requirements would apply above a specified loan to value ratio: up to a low and conservative loan to value ratio, the normal capital requirements for residential real estate lending would continue to apply. However where the loan is made in a currency other than that of the income of the borrower, significant incremental capital requirements should be applied when the loan to value ratio is in excess of 50 per cent and should lead to a full one to one backing by capital requirements as the loan to value ratio reaches 100% and beyond.

These specific incremental capital requirements would only apply to loans granted after the implementation date of these requirements and, for the avoidance of doubt, would

[5] COM(2009)114 http://ec.europa.eu/commission_barroso/president/index_en.htm

apply only to residential mortgage lending in a foreign currency. Existing capital provisions for foreign exchange risk would apply to all other forms of lending.

Suggested provisions to achieve the policy objectives described are set out in Annex 2.

Such additional specific capital requirements should be aimed at guiding the behaviour of credit institutions in the particular instances described above. They are however without prejudice to other legislative and non-legislative initiatives considered necessary to encourage responsible lending more broadly. See in particular the Commission services' consultation on responsible lending.[6]

2.3 QUESTIONS

Question 14: Do you consider that the risk weights suggested will be effective in discouraging unsafe practices and irresponsible lending in foreign currency denominated housing loans?

Question 15: Do you consider a loan to value ratio of 50% or less is sufficient objective evidence that the borrower has sufficient private wealth to withstand currency movements and potentially correlated movements in property prices?

[6] http://ec.europa.eu/internal_market/finservices-retail/credit/responsible_lending_en.htm

SECTION 3

REMOVAL OF NATIONAL OPTIONS AND DISCRETIONS

4.1 TOWARDS A SINGLE RULE BOOK IN BANKING

The Commission's Communication for the Spring European Council of 4 March 2009 stated that "key differences in national legislation stemming from exceptions, derogations, additions made at national level or ambiguities contained in current directives should be identified and removed, so that a harmonised core set of standards is developed and applied throughout the Member States", and called for a 'rolling' plan to deliver a "single rule book".[7] Further harmonisation is also needed to underpin technical standards that will be developed by the European Supervisory Authority under further planned amendments to the CRD which will be proposed in the context of the reform of the EU financial supervisory architecture.

In keeping with these objectives, the Commission services suggest a maximum harmonisation in some technical areas of the CRD, and the deletion of most options and discretions.

4.2 MAXIMUM HARMONISATION

Unless otherwise provided,[8] the CRD is a 'minimum harmonisation' Directive. This is explicitly acknowledged in recital 15 of Directive 2006/48/EC.[9] 'Regulatory additions' or 'super-equivalent provisions' adopted at national level fall into three categories:

- Additions in areas which are not explicitly covered by EU legislation (e.g. the Spanish dynamic provisioning), or not fully harmonised (e.g. supervision of liquidity in accordance with Article 41 of Directive 2006/48/EC);
- Discretionary treatment that is expressly permitted by the CRD in areas which are not fully harmonised (e.g. under Article 61 of Directive 2006/48/EC on the composition of own funds);
- Additions in areas which are fully harmonised.

The Commission's intention is to eliminate only this third category of regulatory 'additions', which is commonly labelled 'gold plating'. In that respect, the scope of the 'maximum harmonisation' that is to be achieved by this exercise needs to be clearly circumscribed. The Commission services suggest limiting it to Pillar 1 (minimum capital

7 See also recommendation 20 of the Larosière report

8 Recital (6) of Directive 2007/44/EC ('Mergers and acquisitions') explains that "Maximum harmonisation throughout the Community of the procedure and the prudential assessments, without the Member States laying down stricter rules, is therefore critical"

9 "The Member States may also establish stricter rules than those laid down in Article 9(1), first subparagraph, Article 9(2) and Articles 12, 19 to 21, 44 to 52, 75 and 120 to 122 for credit institutions authorised by their competent authorities. The Member States may also require that Article 123 be complied with on an individual or other basis, and that the sub-consolidation described in Article 73(2) be applied to other levels within a group".

requirements, large exposures rules) and Pillar 3 (disclosure).[10] Other areas of the Directive do not lend themselves to maximum harmonisation, either i) because they are not yet fully harmonised (e.g. own funds) or ii) because the decisions are based on specific risk assessments (e.g. Pillar 2).

4.3 NATIONAL OPTIONS AND DISCRETIONS

CEBS has identified 101 national options[11] and discretions[12] to be disclosed in CEBS supervisory disclosure framework in accordance with Article 144 of the CRD.[13] The way in which Member States have implemented these options and discretions is disclosed on the CEBS web-site.[14]

The proposed amendments set out in the Annex draw on the technical advice from CEBS[15] while further developing that advice.

152 provisions of the CRD were analysed by CEBS. Of these, the Commission services propose to exclude at this stage options and discretions that relate to own funds and large exposures, and to the scope of application of the Directive, since these will be subject to specific reviews by end 2011 in accordance with the CRD.

The Commission services would like to consult the public in particular on the following issues.

- With respect to residential real estate – the asset class at the very heart of the current crisis – the Commission services suggest (1) that a preferential risk-weight of 35% will be granted only if stricter Loan-To-Value (LTV) requirements are fulfilled; and (2) that any waiver of the requirement the risk of the borrower does not materially depend upon the credit quality of the borrower[16] is conditional on the satisfaction of the 'hard test' in respect of losses[17] which applies for commercial real estate.

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[10] Specifically, Title V, Chapter 2, section 2 – subsection 3 (minimum level of own funds) and Title V, Chapter 2 – sections 3 to 6 (i.e. Articles 76 to 122 covering minimum own funds requirements for credit and operational risk, large exposures and qualifying holdings outside the financial sector) of 2006/48/EC; Title V, Chapter 5 (disclosure by credit institutions) of 2006/48/EC; and Chapter V, section 1 (provisions against risks) and section 4 (large exposures) of Directive 2006/49/EC.

[11] An option refers to cases where competent authorities or Member States may choose how to comply with a given provision within a range of specified alternatives. For examples, for purposes of risk-weighting institutions or local authorities, they may apply either the central government risk-weight based method or the credit assessment based method. Options granted to credit institutions to flexibly make use of prudential treatments reflecting different risk management processes are not included in this list.

[12] Discretion refers to a situation in which competent authorities or Member States are given a choice as to whether to apply a given provision. For example, a competent authority under particular circumstances can apply a 50% risk-weight to commercial real estate, or waive capital requirements at solo level for domestic subsidiaries.

[13] Under Article 144 (b), competent authorities are required to disclose the manner by which the options and discretions available in Community legislation are exercised.

[14] www.c-ebs.org

[15] CEBS Technical Advice to the European Commission on Options and National Discretions, published on 17 October 2008, in response to the Commission's request for advice of 27 March 2007.

[16] Annex VI, Part 1, points 48 and 49.

[17] Existing Annex VI, Part 1, point 58: (a) losses stemming from lending collateralised by commercial real estate property up to 50% of the market value (or where applicable and if lower 60% of the mortgage lending value (MLV) do not exceed 0,3% of the outstanding loans collateralised by

- With respect to commercial real estate, the 'hard test' on losses (see above) will apply more generally as a condition for the preferential treatment of in Member States, rather than only as a condition for the waiver of the requirement that the risk of the borrower does not materially depend upon the credit quality of the borrower.[18] That is, identical and stricter LTV requirements will be a condition for the preferential risk weights for both commercial and residential real estate lending.

- The Commission services suggest a single definition of default (90 days) by 31 December 2012. However, we would welcome views as to whether this timeline (2012) is appropriate in view of changes to banks' systems.

4.4 QUESTIONS

Question 16: Is this suggested scope of maximum harmonisation in 2006/48/EC and 2006/49/EC appropriate?

Question 17: Is the suggested prudential treatment for both residential and commercial real estate is sufficiently sound?

Question 18: Is the suggested timeline (2012) for a single definition of default (i.e. 90 days) is appropriate.

commercial real estate property in any given year; and (b) overall losses stemming from lending collateralised by commercial real estate must not exceed 0,5% of the outstanding loans collateralised by commercial real estate property in any given year.

18 Annex VI, Part 1, points 58 and 54(b)

SECTION 4

SIMPLIFICATION OF THE BANK BRANCH ACCOUNTS DIRECTIVE

5.1 INTRODUCTION

As part of the Commission's legislative simplification exercise for 2009, the Commission services have reviewed the implementation of the Directive 89/117/EEC ('the Bank Branch Accounts Directive').[19]

The Bank Branch Accounts Directive prohibits any requirement on branches of banks from other Member States to publish annual accounts relating to their own activities. However, the Directive sets out other accounting information that branches of credit and financial institutions with their headquarters in another Member State can be required to publish. A survey by the Commission Services indicates that:

- In 19 Member States, branches are not required to publish any additional information beyond the accounting documents of the parent credit or financial institution.
- 8 Member States do require branches to publish additional information, three of which require publication of all additional information possible under the Directive, rather than selecting individual items from the list of options.
- A majority of Member States (17 out of 27) require branches of credit or financial institutions from third countries without reciprocity agreements with the EU to publish full annual accounts relating to their own activities.

The fact that branches in some Member States are not required to publish other accounting information does not mean that the branch does not collect accounting data, since (irrespective of the provisions in question, branches are required to maintain their own accounting systems.

5.2 PRELIMINARY CONCLUSIONS

The Commission services assessed the usefulness of published branch accounting information for the following user groups: supervisors, tax authorities, depositors and creditors:

- Supervisors, tax authorities have, through their own reporting requirements, in any event access to unpublished accounting information that the branch is required to maintain.

[19] Directive 89/117/EEC on the obligations of branches established in a Member State of credit institutions and financial institutions having their head offices outside that Member State regarding the publication of annual accounting documents, OJ No L 44, 16.2.1989, p.40.

- For depositors and creditors the Commission services conclude that the credit institution as a whole rather than the individual branch is more relevant for meeting creditors' and depositors' claims.

Based on the user analysis, the Commission services conclude that there is little added value in the publication of additional accounting information by branches from credit institutions established in other Member States. The Commission services therefore suggest removing the option for Member States to require the publication of additional information by branches of EU banks. Deleting this option would reduce the reporting (and audit) requirements for at least 200 branches of credit or financial institutions. However, the cost savings envisaged may not be substantial in comparison to other compliance costs faced by the banking sector.

In order to achieve this policy objective, Article 2(4) of the Directive 89/117/EEC would be deleted. The text of this provision is set out, for ease of reference, in Annex 5.

Question 19: Do you agree that the Bank Branch accounts Directive 89/117/EEC should be amended so that Member States can no longer require the publication of <u>additional</u> information by branches of credit institutions established in other Member States?

SECTION 5

SUMMARY OF QUESTIONS

Introduction

Question 1: What impact would the changes proposed in each section of this paper have on your activities or activities of firms in your jurisdiction, including costs linked to increase in regulatory capital and any other compliance costs?

Question 2: Do you have any views about any aggregate impact of the proposed changes to capital requirements?

Question 3: What is the optimal timing for these measures? Should their application be sequenced?

Section 1 (Through-the-cycle expected loss provisioning)

Question 4: The Commission services suggest that the through-the-cycle value adjustment should not count as regulatory capital (see ANNEX 1, suggested amendment to Article 57). Do you agree?

Question 5: Should off-balance sheet items be captured under the formula for through-the-cycle expected loss provisioning, given that 'provisions' for off-balance sheet items are not recognised in all relevant accounting standards? Should only assets subject to an impairment test be subject to through-the-cycle expected loss provisioning? (See ANNEX 1, suggested Article 74a (2).)

Question 6: At this point, the suggestion is not to include the option for competent authorities to allow internal methods to determine expected losses across an economic cycle. As an alternative to the regulatory approach to calculate counter-cyclical factors, would it be desirable to allow firms' internal methodologies (to be validated by supervisors)?

Question 7: Should the exposure class of Article 86 (i.e. for credit institutions subject to the IRB approach) be used irrespective of the fact that the credit institution may be under the Standardised approach? It may be noted that a mapping between exposures class under the Standardised approach and under the IRB is already used in the prudential reporting system of some Member States. As an alternative, should countercyclical parameters be defined for the 16 exposures classes under the Standardised approach? (See ANNEX 1, suggested Article 74a (1).)

Question 8: Please give your views on the following approaches:

1) the Spanish model of through-the-cycle expected loss provisioning;

2) a 'simplified' Spanish model.

In particular, we would welcome views on the relative merits of both options in terms of the building up of provisions in a graduated manner over time (See ANNEX 1, suggested Annex IXb).

Question 9: Should new risk categories (as suggested above) be introduced along the lines of the Spanish system or, alternatively, should the current risk categories of the CRD (e.g. credit quality steps in Annex VI) be used? (See ANNEX 1, suggested Annex IXb.)

Question 10: Is the 'location of the borrower' (as opposed to the booking of the exposure) the right approach, with a view to avoiding regulatory arbitrage? (See ANNEX 1, suggested Annex IXb 2.)

Question 11: Will the data to determine counter-cyclical factors be easily available?

Question 12: Please give your views on the methodologies for calculating the through-the-cycle expected loss provisions at consolidated level. (See ANNEX 1, amended Article 73.)

Question 13: Please give your views on the scope of disclosure requirements for through-the-cycle expected loss provisioning. (See ANNEX 1, suggested amendment to Annex XII (17).)

Section 2 (Residential mortgages denominated in a foreign currency)

Question 14: Do you consider that the risk weights suggested will be effective in discouraging unsafe practices and irresponsible lending in foreign currency denominated housing loans?

Question 15: Do you consider a loan to value ratio of 50% or less is sufficient objective evidence that the borrower has sufficient private wealth to withstand currency movements and potentially correlated movements in property prices?

Section 3 (Removal of national options and discretions)

Question 16: Is this suggested scope of maximum harmonisation in 2006/48/EC and 2006/49/EC appropriate?

Question 17: Is the suggested prudential treatment for both residential and commercial real estate is sufficiently sound?

Question 18: Is the suggested timeline (2012) for a single definition of default (i.e. 90 days) is appropriate.

Section 4 (Simplification of the Bank Branch Accounts Directive)

Question 19: Do you agree that the Bank Branch accounts Directive 89/117/EEC should be amended so that Member States can no longer require the publication of additional information by branches of credit institutions established in other Member States.

ANNEX 1

DRAFT TEXT FOR AMENDMENTS TO THE CRD ON THROUGH-THE-CYCLE EXPECTED LOSS PROVISIONING

Underlined sections indicate proposed new text.
Strikethrough indicates proposed deletions of existing text.

The proposed recitals below clarify the objectives of the legal drafting that follows. International accounting standard setters are currently considering improvements to the impairment methodology (i.e. 'value adjustments' in the CRD terminology). These improvements will in the understanding of the Commission services enable more forward looking provisioning for loan losses. In the view of the Commission services, European banks should make use of the more forward looking provisioning possibilities that these improvements will offer in a way that is conducive to promoting financial stability and a level playing field. To this end, the Commission services are consulting the public on the possibility of introducing a methodology that would apply to banks only and would guide their loan loss provisioning practices under a new impairment methodology. Such a prudential measure would in particular aim at establishing forward looking minimum levels of provisions on a portfolio level. The Commission services stress their intention not to prejudge any decisions of the international accounting standard setter.

In addition, the Commission services consider that there may be a need to provision in a forward-looking manner for off-balance sheet credit risks ('provisions' in the CRD terminology) such as those from guarantees. The Commission services seek comments on the desirability of possible coverage of off-balance sheet credit risks by a methodology to guide banks' loan loss provisioning practices.

In the Declaration on Strengthening the Financial System of 2 April 2009, the leaders of the G20 requested that accounting standard setters should strengthen accounting recognition of loan loss provisions by considering alternative approaches for recognizing and measuring loan losses that incorporate a broader range of available credit information, and that regulators, working with accounting standard setters, should strengthen prudential regulatory standards to mitigate pro-cyclicality. In keeping with this policy objective, **international accounting setters are reviewing the impairment methodology.**

It is of key importance for the completion of the internal market, and for financial stability purposes, that value adjustments and provisions for off-balance sheet credit risk are made in a common and consistent manner by credit institutions. Therefore, an appropriate methodology should be developed at EU level. To this end, it is appropriate to use a formula based approach in order to create a minimum level of value adjustments, and where relevant provisions, on an overall portfolio level. Such formula-based minimum level should be without prejudice to a possible higher level of value adjustments and, where relevant, provisions following credit institutions' own assessment of the necessary level of value adjustments. Formula-based through-the-cycle expected loss provisioning consists in making value adjustments on loan portfolios and where relevant provisions on off-balance sheet items to be charged in good times and be reversed in bad times.

The Commission services suggest that the through-the-cycle expected loss provisioning should not be accounted for regulatory capital. As opposed to own funds which cover 'unexpected losses' in the Basel 2 methodology, provisions cover expected losses. Therefore, the Commission services intend to exclude through-the-cycle expected loss provisions from regulatory own funds

Article 57

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

…/….

<u>The through-the-cycle expected loss provision under Article 74a shall not be included in any of these items.</u>

The following proposed new Article requires credit institutions to calculate a through-the-cycle expected loss provision, and explains how this through-the-cycle expected loss provision is calculated. This Article is complemented by further details in Annex IXb. A Level 2 implementing measure (or a technical standards proposed by the European Supervisory Authority) should further specify the statistical methodology.

Article 74a

1. Competent authorities shall require that credit institutions, in accordance with the prudential methodology laid down in Annex IXb make value adjustments and provisions with regard to credit risks over the course of a full economic cycle ("through-the-cycle expected loss provision"), and where necessary in excess of value adjustments and provisions otherwise considered necessary by the credit institution for individual items and portfolios. The competent authorities shall determine the parameters for calculating the through-the-cycle expected loss provision for the exposures classes defined in Article 86 (1) (a) to (d) and 86 (1) (f) and (g) at the date of reporting pursuant to article 74(2) according to the methodology laid down in Annex IXb.

2. Through-the-cycle expected loss provisioning applies to all credit institutions with respect to those non-trading [i.e. banking] book debt instruments for which value adjustment and provisions are made in accordance with relevant accounting standards.

3. The countercyclical parameters shall be based on statistical data covering a full economic cycle. The countercyclical parameters for each of the exposure classes referred to in paragraph 1 shall be calibrated on the basis of risk typology laid down in Annex IXb.

4. When the through the cycle provision at the date of annual accounts declines compared to the amount accumulated in the previous financial year, the difference shall be corrected in the value adjustment and provisions.

5. The competent authority shall annually review the parameters to determine the countercyclical factors. They shall be updated if necessary to reflect changes in underlying statistical data.

The Spanish system of through-the-cycle expected loss provisioning (option 1) incorporates two coefficients (α and β) that reflect the historical average estimate of the credit loss for each risk category (α), applied to the increased amount in the loan portfolio and the historical average specific provision for each risk category (β), applied to the total loan portfolio. However, since the IASB might change the current incurred loss model into an expected cash flow model, the α factor could become redundant. Therefore, option 2 is suggested

Annex IXb

THROUGH-THE-CYCLE EXPECTED LOSS PROVISION

Method 1

1. The through-the-cycle expected loss provision is calculated as follows:

$$TELP = \sum \alpha \Delta C_t + \sum \left(\beta - \frac{SP_t}{C_t} \right) C_t$$

where:

- TELP: Through the Cycle Expected Loss Provision charged/reversed in the profit and loss in period t;
- SP: Specific Provisions in the form of value adjustments and provisions for individual items and portfolios charged/reversed in the P&L in period t;
- Ct: End of the period t overall portfolio of relevant items for which no Specific Provisions have been taken;
- α: Historical average estimate of the credit loss for six homogeneous risk categories;
- ß: Historical average Specific Provision for six homogeneous risk categories.

2. The competent authorities of each Member States shall determine the countercyclical factor for borrowers located in this Member State. For borrowers located in other Member States, the credit institutions shall apply the countercyclical factors determined by the competent authorities of that Member State. For borrower located in third countries, the Committee of European Banking Supervisors [the European Banking Authority] shall develop the countercyclical factors that the credit institutions shall apply at individual or at consolidated level in accordance with Article 68 and 71.

3. The determination of the countercyclical factors by the competent authorities and the Committee of European Banking Supervisors [the European Banking Authority] shall be based on analyses provided by the European Systemic Risk Board.

4. The countercyclical factor for each of the risk exposure classes shall be calibrated on the basis of the following risk categories:

   (a) Negligible risk
   (b) Low risk
   (c) Medium-low risk
   (d) Medium risk
   (e) Medium-high risk
   (f) Full risk

Method 2

1. The through-the-cycle expected loss provision is calculated as follows:

Through-the-cycle expected loss provision = (β *exposure) – value adjustment and provisions under relevant accounting standards

Exposure shall mean:

(a) the balance sheet value of asset items which are subject to value adjustments according to relevant accounting standards;

(b) 100 % of the value of off-balance sheet items which are subject to provision according to relevant accounting standards.

The "through-the-cycle expected loss provision" for a class of exposures is the difference between the total amount of the nominal value gross of value adjustment and provisions for off- and on balance sheet exposures at the end of the financial year multiplied by the countercyclical factor minus the accumulated value adjustments and provisions determined under Article 74(1).

2. The competent authorities of each Member States shall determine the countercyclical factor for borrowers located in this Member State. For borrowers located in other Member States, the credit institutions shall apply the countercyclical factors determined by the competent authorities of that Member State. For borrower located in third countries, the Committee of European Banking Supervisors [the European Banking Authority] shall develop the countercyclical factors that the credit institutions shall apply at individual or at consolidated level in accordance with Article 68 and 71.

3. The determination of the countercyclical factors by the competent authorities and the Committee of European Banking Supervisors [the European Banking Authorities] shall be based on analyses provided by the European Systemic Risk Board.

4. The countercyclical factor for each of the risk exposure classes shall be calibrated on the basis of the following risk categories:

(a) Negligible risk
(b) Low risk
(c) Medium-low risk
(d) Medium risk
(e) Medium-high risk
(f) Full risk

The purpose of the following amendments is to apply through-the-cycle expected loss provisioning at the level of an individual bank, and at consolidated level. The methodology to perform consolidation is specified in Annex IXb. At consolidated level, banks are expected to add-up the provisions calculated at solo level, provided that those exposures are reflected in the consolidated financial statements.

Article 68

1. Credit institutions shall comply with the obligations laid down in Articles 22, 74a and 75 and Sections 5 and 5a on an individual basis.

2. Every credit institution which is neither a subsidiary in the Member State where it is authorised and supervised, nor a parent undertaking, and every credit institution not included in the consolidation pursuant to Article 73, shall comply with the obligations laid down in Articles 120 and 123 on an individual basis.

3. Every credit institution which is neither a parent undertaking, nor a subsidiary, and every credit institution not included in the consolidation pursuant to Article 73, shall comply with the obligations laid down in Chapter 5 on an individual basis.

Article 71

1. Without prejudice to Articles 68 to 70, parent credit institutions in a Member State shall comply, to the extent and in the manner prescribed in Article 133, with the obligations laid down in Articles <u>74a</u>, 75, 120, 123 and Section<u>s</u> 5 and 5a on the basis of their consolidated financial situation.

2. Without prejudice to Articles 68 to 70, credit institutions controlled by a parent financial holding company in a Member State shall comply, to the extent and in the manner prescribed in Article 133, with the obligations laid down in Articles <u>74a</u>, 75, 120 and 123 and Sections 5 <u>and 5a</u> on the basis of the consolidated financial situation of that financial holding company.

   Where more than one credit institution is controlled by a parent financial holding company in a Member State, the first subparagraph shall apply only to the credit institution to which supervision on a consolidated basis applies in accordance with Articles 125 and 126.

Article 73

2. Competent authorities shall require subsidiary credit institutions to apply the requirements laid down in Articles <u>74a</u>, 75, 120 and 123 and Section 5 <u>and 5a</u> on a sub-consolidated basis if those credit institutions, or the parent undertaking where it is a financial holding company, have a credit institution or a financial institution or an asset management company as defined in Article 2(5) of Directive 2002/87/EC as a subsidiary in a third country, or hold a participation in such an undertaking.

The amendments proposed to Annex XII would include through-the-cycle expected loss provisioning within disclosure provisions.

PART 2

General requirements

<u>17. The following information shall be disclosed regarding compliance by the credit institution with the requirements laid down in Article 74a:</u>

- <u>(a)</u> the level of the through-the-cycle expected loss provision for each exposure class
- <u>(b) the exposures to which the countercyclical factors are applied for each Member States and third country in which borrowers are located, and for each risk category of Annex IXb.</u>
- <u>(c) the changes in the through-the-cycle expected loss provision compared to the previous reporting period for each exposure class</u>

Article 144

Competent authorities shall disclose the following information:

(a) the texts of laws, regulations, administrative rules and general guidance adopted in their Member State in the field of prudential regulation;

(b) the manner of exercise of the options and discretions available in Community legislation;

(c) the general criteria and methodologies they use in the review and evaluation referred to in Article 124; and

(d) without prejudice to the provisions laid down in Chapter 1, Section 2, aggregate statistical data on key aspects of the implementation of the prudential framework in each Member State.

<u>(e) a description of how they implement the methodology for determining the counter-cyclical factors under Article 74a and the amount of the counter-cyclical factor for each risk category.</u>

The disclosures provided for in the first subparagraph shall be sufficient to enable a meaningful comparison of the approaches adopted by the competent authorities of the different Member States. The disclosures shall be published with a common format, and updated regularly. The disclosures shall be accessible at a single electronic location.

The following amendment suggests introducing a Level 2 implementing measure to further specify the methodology of through-the-cycle expected loss provisioning

Art 150a

<u>The Commission shall adopt implementing measures to specify the method for determining the through-the-cycle expected loss provision under article 74a and Annex IXb.</u>

<u>The Commission shall adopt implementing measures to specify the method for taking into account the exposures described as ‘off balance sheet’ in Annex IXb. ‘Off balance sheet exposures’ are non-trading exposures which do not arise from recognised balance sheet assets. They include, but are not limited to, loan commitments; financial guarantees; endorsements and acceptances; exposures arising from international trade finance; and financial derivatives not recognised under the accounting standards applied by a bank.</u>

ANNEX 2

DRAFT TEXT FOR AMENDMENTS TO THE CRD TO INTRODUCE SPECIFIC CAPITAL REQUIREMENTS FOR RESIDENTIAL PROPERTY LOANS IN A FOREIGN CURRENCY

In Annex VI, Part 1 the following new points are added:

50a. Other requirements in this Annex notwithstanding, exposures shall be risk weighted as set out in this point if they are fully or partially secured in the manner specified in points 45 to 47 and denominated in a currency that is not the one of the Member State or third country where the residential property is located:

a) The part of the exposure that does not exceed [50%] of the market value of the property in accordance with the valuation rules set out in Annex VIII Part 3 points 62 to 65 shall be risk weighted as otherwise specified in this Annex;

b) The part of the exposure that exceeds [50%] of the market value of the property in accordance with the valuation rules set out in Annex VIII Part 3 points 62 to 65 but does not exceed [100%] of the market value shall be assigned a risk weight of

$$RW_B = RW_A * [1 - 2(p - 50\%)] + 1250\% * 2(p - 50\%)$$

where:
RW_B is the risk weight assigned according to this letter b);
RW_A is the risk weight assigned according to letter a); and
p is the ratio of the value of the exposure to the market value of the property in accordance with the valuation rules set out in Annex VIII Part 3 points 62 to 65; and

c) The part of the exposure that exceeds [100%] of the market value of the property in accordance with the valuation rules set out in Annex VIII Part 3 points 62 to 65 shall be assigned a risk weight of 1250%.

50b Point 50a shall not apply in cases where the borrower or guarantor or both have a stable and sustainable source of freely available income in the currency in which the exposure is denominated provided, based on prudent downside sensitivity scenario analysis, it can be reasonably be deemed to be sufficient – after taking account of other debt servicing obligations in that currency as well as other ongoing outgoings – to meet the immediate and longer term debt servicing obligations on the residential mortgage. It shall further not apply to loans granted before [implementation date of this directive].

In Annex VII, Part 1, the following new points are added:

12a. Other requirements in this Annex not withstanding, exposures shall be risk weighted as set out in this point if they are fully or partially secured by mortgages on residential property, Finnish housing shares or in the form of residential property leasing and denominated in a currency that is not the one of the Member State or third country where the residential property is located:

a) The part of the exposure that does not exceed [50%] of the market value of the property in accordance with the valuation rules set out in Annex VIII Part 3 points 62 to 65 shall be risk weighted as otherwise specified in this Annex;

b) The part of the exposure that exceeds [50%] of the market value of the property in accordance with the valuation rules set out in Annex VIII Part 3 points 62 to 65 but does not exceed [100%] of the market value shall be assigned a risk weight of

$$RW_B = RW_A * [1 - 2(p - 50\%)] + 1250\% * 2(p - 50\%)$$

where:

RW_B is the risk weight assigned according to this letter b);

RW_A is the risk weight assigned according to letter a); and

p is the ratio of the value of the exposure to the market value of the property in accordance with the valuation rules set out in Annex VIII Part 3 points 62 to 65; and

c) The part of the exposure that exceeds [100%] of the market value of the property in accordance with the valuation rules set out in Annex VIII Part 3 points 62 to 65 shall be assigned a risk weight of 1250%.

12b. Point 12a shall not apply in cases where the borrower or guarantor or both have a stable and sustainable source of freely available income in the currency in which the exposure is denominated provided, based on prudent downside sensitivity scenario analysis, it can be reasonably be deemed to be sufficient – after taking account of other debt servicing obligations in that currency as well as other ongoing outgoings – to meet the immediate and longer term debt servicing obligations on the residential mortgage. It shall further not apply to loans granted before [implementation date of this directive].

ANNEX 3

DRAFT TEXT FOR AMENDMENTS TO THE CRD TO REMOVE NATIONAL OPTIONS AND DISCRETIONS

The purpose of the following suggested amendments is to specify the scope of 'maximum harmonisation' in Directive 2006/48/EC (Article 157a) and in Directive 2006/49/EC (Article 49a)

Article 157a

"157a. By 31 December 2012, Member States shall remove all national provisions that are stricter than those laid down in Title V, Chapter 2, Section 2, Subsection 3, Title V, Chapter 2, Sections 3 to 6 and Title V, Chapter 5 of this Directive."

Article 49a

"By 31 December 2012, Member States shall remove all national provisions that are stricter than those laid down in Chapter V, Sections 1 and 4 of this Directive."

The amendments in this section remove options and national discretions from Directive 2006/48/EC.

1. Article 72(3) is replaced by the following:

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

2. Article 80(3) is replaced by the following:

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

3. Article 81(3) is replaced by the following:

   "If an ECAI seeks to be recognised as eligible in more than one Member State, the Committee of European Banking Supervisor shall carry out the ~~has been recognised as eligible by the competent authorities of a Member State, the competent authorities of other Member States may recognise that ECAI as eligible without carrying out their own~~ evaluation process referred to in paragraph 2.".

4. Article 82(2) is replaced by the following:

"2. ~~When the competent authorities of a Member State have made a determination under paragraph 1, the competent authorities of other Member States may recognise that determination without carrying out their own determination process". ~~For ECAIs referred to in Article 81(3), the Committee of European Banking Supervisor shall make the determination referred to in paragraph (1).".

5. The second subparagraph of Article 84(2) is replaced by the following:

"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, working together in accordance with Article 129(2), ~~may~~ shall allow, in a way consistent with of the structure of the group and its risk management processes and methodologies, minimum requirements of Annex VII, Part 4 to be met by the parent and its subsidiaries considered together.".

6. The second subparagraph of Article 89(1) is replaced by the following:

"This paragraph shall not prevent the competent authorities of other Member States from allowing the application of the rules of Subsection 1 (standardised approach) for equity exposures referred to in points (f) and (g) which have been allowed for this treatment in other Member States.".

7. Article 97(3) is replaced by the following:

"3. If an ECAI ~~has been recognised as eligible by the competent authorities of a Member State for the purposes of paragraph 1, the competent authorities of other Member States may recognise that ECAI as eligible for those purposes without carrying out their own~~ seeks to be recognised as eligible in more than one Member State, the Committee of European Banking Supervisor shall carry out the evaluation process.".

8. Article 98(2) is replaced by the following:

"2. ~~When the competent authorities of a Member State have made a determination under paragraph 1, the competent authorities of other Member States may recognise that determination without carrying out their own determination process.~~ For ECAIs referred to in Article 97(3), the Committee of European Banking Supervisor shall make the determination process to in paragraph (1).".

9. Article 102(4) is replaced by the following:

"4. ~~Competent authorities may allow~~ Credit institutions ~~to~~ may use a combination of approaches subject to compliance with the requirements set out in ~~accordance with~~ Annex X, Part 4.".

10. Article 104(3) is replaced by the following:

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

11. Article 105(4) is replaced by the following:

"4. Where an EU parent credit institution and its subsidiaries or the subsidiaries of an EU parent financial holding company use an Advanced Measurement Approach on a unified basis, the competent authorities, working together in accordance with Article 129(2), shall allow, in a way consistent with the structure of the group and its risk management processes and methodologies, ~~may~~ the qualifying criteria set out in Annex X, Part 3 to be met by the parent and its subsidiaries considered together.".

12. Article 122 is amended as follows:

(a) The first paragraph is replaced by the following:

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

(b) The second paragraph is replaced by the following:

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

13. Article 154(6) is replaced by the following:

"6. Until 31 December 20~~17~~12, 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. Competent authorities shall make public the categories of equity exposures which benefit from this treatment.".

14. Annex III, Part 3 is amended as follows:

(a) The paragraph below Table 1 is replaced by the following:

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

(b) A new paragraph is introduced below Table 2:

"The Commission shall review the implementation of this provision and Table 2 by 31 December 2012.".

15. Annex III, Part 6 is amended as follows:

(a) Point 7 is replaced by the following:

"7. The exposure value shall be calculated as the product of α times Effective EPE, as follows:

Exposure value = α × Effective EPE

where:

alpha (α) shall be no less than 1.4 ~~, but competent authorities may require a higher α,~~ and effective EPE shall be computed by estimating expected exposure (EEt) as the average exposure at future date t, where the average is taken across possible future values of relevant risk factors. The model estimates EE at a series of future dates t1, t2, t3 etc.";

(b) The first sentence of point 12 is replaced by the following:

"12. Notwithstanding point 7,~~ competent authorities may permit~~ credit institutions may use their own estimates of α, subject to a floor of 1.2 where α shall equal the ratio of internal capital from a full simulation of CCR exposure across counterparties (numerator) and internal capital based on EPE (denominator).".

16. In Annex III, Part 7 the last item of point (c)(ii) is replaced by the following:

" — NGR = 'net-to-gross ratio': ~~at the discretion of the competent authorities either: (i) separate calculation~~: the quotient of the net replacement cost for all contracts included in a legally valid bilateral netting agreement with a given counterparty (numerator) and the gross replacement cost for all contracts included in a legally valid bilateral netting agreement with that counterparty (denominator)~~, or (ii) aggregate calculation: the quotient of the sum of the net replacement cost calculated on a bilateral basis for all counterparties taking into account the contracts included in legally valid netting agreements (numerator) and the gross replacement cost for all contracts included in legally valid netting agreements (denominator)~~.".

17. Annex VI, Part 1 is amended as follows:

(a) Point 5 is replaced by the following:

"5. When the competent authorities of a third country which apply supervisory and regulatory arrangements at least equivalent to those applied in the Community assign a risk weight which is lower than that indicated in point 1 to 2 to exposures to their central government and central bank denominated and funded in the domestic currency, competent authorities shall allow their credit institutions to risk weight such exposures in the same manner. To this end, the Committee of European Banking Supervisors shall conduct an assessment of the supervisory and regulatory arrangements of the third country in question.";

(b) Point 11 is replaced by the following:

"11. When competent authorities of a third country jurisdiction which apply supervisory and regulatory arrangements at least equivalent to those applied in the Community treat exposures to regional governments and local authorities as exposures to their central government and there is no difference in risk between such exposures owing to the specific revenue-raising powers of regional government and local authorities and to specific institutional arrangements to reduce the risk of default exist, the competent authorities shall allow their credit institutions to risk weight exposures to such regional governments and local authorities in the same manner. To this end, the Committee of European Banking Supervisors shall conduct an assessment of the supervisory and regulatory arrangements of the third country in question.";

(c) Point 14 is replaced by the following:

"14. ~~Subject to the discretion of competent authorities~~ The competent authorities shall draw up and make public a list of domestic public sector entities exposures to which may be treated as exposures to institutions, or the criteria for identifying such domestic public entities. Exposures to public sector entities may be treated as exposures to institutions provided that the respective public sector entity is on the list drawn up by a competent authority or fulfils the criteria for identifying public entities eligible for treating them as institutions. ~~Exercise of this discretion by competent authorities is independent of the exercise~~. ~~of discretion as specified in Article 80(3).~~ The preferential treatment for short-term exposures specified in point~~s 31, 32 and~~ 37 shall not be applied.";

(d) Point 15 is replaced by the following:

"15. In cases where there is no difference in risk between exposures to domestic public sector entities and exposures to the central government in whose jurisdiction they are established because owing to the existence of an appropriate guarantee by the central government, the competent authorities shall draw up and make public a list of those public sector entities exposures to which may be treated as exposures to central government, or the criteria for identifying such public entities. ~~In exceptional circumstances, exposures to public sector entities may be treated as exposures to the central government in whose jurisdiction they are established where in the opinion of the competent authorities there is no difference in risk between such exposures because of the existence of an appropriate guarantee by the central government.~~";

(e) Point 16 is replaced by the following:

"16. When exposures ~~the discretion to treat exposures~~ to public-sector entities are treated as exposures to institutions or as exposures to the central government in whose jurisdiction they are established ~~is exercised by the competent authorities of one~~ in one Member State, the competent authorities of another Member State shall allow their credit institutions to risk-weight exposures to such public-sector entities in the same manner.";

(f) Point 17 is replaced by the following:

"17. When competent authorities of a third country jurisdiction which apply supervisory and regulatory arrangements at least equivalent to those applied in the Community treat exposures to its public sector entities as exposures to institutions, and there is no difference in risk between such exposures and those of institutions, the competent authorities shall allow their credit institutions to risk weight exposures to such public sector entities in the same manner. To this end, the Committee of European Banking Supervisors shall conduct an assessment of the supervisory and regulatory arrangements of the third country in question.";

(g) Point 23 is deleted;

(h) Section 6.2 is deleted;

(i) The section number and title of Section 6.3 is deleted;

(j) Point 27 is replaced by the following:

"27. For exposures to institutions incorporated in countries where the central government is unrated, the risk weight shall be ~~not more than~~ 100 %.";

(k) Sections 6.4 and 6.5 are deleted;

(l) The section number and title of section 6.6 is deleted;

(m) Point 37 is replaced by the following:

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

(n) In point 40, the introductory phrase is replaced by the following:

"40. ~~Where an~~ Exposure to an institution in the form of minimum reserves required by the ECB or by the central bank of a Member State to be held by a credit institution may be risk-weighted as~~, Member States~~ ~~may permit the assignment of the risk weight that would be assigned to~~ exposures to the central bank of the Member State in question provided:";

(o) A new point 44a is added:

"44a. For the purpose of implementing point 49, 53a and 58, competent authorities shall assess, disclose and explain the extent to which a well-developed and long-established residential real estate market is present in their territory. The Committee of European Banking Supervisors shall develop guidelines for this assessment.";

(p) Sections 9.1 and 9.2 are replaced by the following:

"9.1**. Exposures secured by mortgages on residential property**

45. Exposures or any part of an exposure fully and completely secured~~, to the satisfaction of the competent authorities,~~ by mortgages on residential property which is or shall be occupied or let by the owner, or the beneficial owner in the case of personal investment companies, shall be assigned a risk weight of 35 %.

46. Exposures fully and completely secured~~, to the satisfaction of the competent authorities,~~ by shares in Finnish residential housing companies, operating in accordance with the Finnish Housing Company Act of 1991 or subsequent equivalent legislation, in respect of residential property which is or shall be occupied or let by the owner shall be assigned a risk weight of 35 %.

47. Exposures to a tenant under a property leasing transaction concerning residential property under which the credit institution is the lessor and the tenant has an option to purchase, shall be assigned a risk weight of 35 % provided that ~~the competent authorities are satisfied that~~ the exposure of the credit institution is fully and completely secured by its ownership of the property.

48. ~~In the exercise of their judgement~~ Credit institutions shall consider an exposure or any part of an exposure as fully and completely secured for the purposes of points 45 to 47~~, competent authorities shall be satisfied~~ only if the following conditions are met:

(a) the value of the property does not materially depend upon the credit quality of the obligor. This requirement does not preclude situations where purely macro-economic factors affect both the value of the property and the performance of the borrower;

(b) the risk of the borrower does not materially depend upon the performance of the underlying property or project, but rather on the underlying capacity of the borrower to repay the debt from other sources. As such, repayment of the facility does not materially depend on any cash flow generated by the underlying property serving as collateral;

(c) the minimum requirements set out in Annex VIII, Part 2, point 8 and the valuation rules set out in Annex VIII, Part 3, points 62 to 65 are met; and

(d) ~~the value of the property exceeds the exposures by a substantial margin.~~ the 35% risk weight is assigned only to the part of the loan that does not exceed a limit calculated in accordance to either of the following conditions:

(i) 40% of the market value of the property in question;

(ii) 40% of the market value of the property or 50 % of the mortgage lending value, whichever is lower, in those Member States that have laid down rigorous criteria for the assessment of the mortgage lending value in statutory or regulatory provisions.

49. ~~Competent authorities~~ Credit institutions may dispense with the condition contained in point 48(b) for exposures fully and completely secured by mortgages on residential property which is situated within the~~ir~~ territory of a Member State, if the relevant competent authority has decided on the basis of ~~they have~~ evidence that a well-developed and long-established residential real estate market is present in ~~their~~ that territory with loss rates which ~~are sufficiently low to justify such treatment.~~ do not exceed the following limits:

(a) losses stemming from lending collateralised by residential real estate property up to 40 % of the market value (or where applicable and if lower 50 % of the mortgage lending value (MLV)) do not exceed 0,3 % of the outstanding loans collateralised by residential real estate property in any given year; and

(b) overall losses stemming from lending collateralised by residential real estate property must not exceed 0,5 % of the outstanding loans collateralised by residential real estate property in any given year.

49a. If either of the limits referred to in point 49 is not satisfied in a given year for a particular territory, point 49 shall cease to apply for exposures secured by mortgages on residential property which is situated within that territory and the condition contained in point 48(b) shall apply until the conditions in point 49 are satisfied in a subsequent year.

50. When the competent authority of a Member State has taken a positive ~~discretion contained~~ decision in respect of the real estate market in the territory of that State in accordance with point 49, ~~the competent authorities~~ credit institutions in ~~of an~~other Member States may ~~allow their credit institutions to~~ assign a risk weight of 35 % to exposures fully and completely secured by mortgages on residential property situated within that territory.

9.2. **Exposures secured by mortgages on commercial real estate**

51. Subject to point 53a, ~~the discretion of the competent authorities,~~ exposures or any part of an exposure fully and completely secured~~, to the satisfaction of the competent authorities,~~ by mortgages on offices or other commercial premises ~~situated within their territory~~ may be assigned a risk weight of 50 %.

52. Subject to point 53a, ~~the discretion of the competent authorities,~~ exposures fully and completely secured, to the satisfaction of the competent authorities, by shares in Finnish housing companies, operating in accordance with the Finnish Housing Company Act of 1991 or subsequent equivalent legislation, in respect of offices or other commercial premises may be assigned a risk weight of 50 %.

53. Subject to point 53a, ~~the discretion of the competent authorities,~~ exposures related to property leasing transactions concerning offices or other commercial premises ~~situated in their territories~~ under which the credit institution is the lessor and the tenant has an option to purchase may be assigned a risk weight of 50 % provided that the exposure of the credit institution is fully and completely secured to the satisfaction of the competent authorities by its ownership of the property.

53a. Credit institutions may apply the 50% risk weight referred to in points 51 to 53 only for exposures fully and completely secured by mortgages on commercial property which is situated within the territory of a Member State, if the competent authority of that Member State has decided, on the basis of evidence, that a well-developed and long-established commercial real estate market is present in that territory with loss rates which do not exceed the following limits:

(a) losses stemming from lending collateralised by commercial real estate property up to 40 % of the market value (or where applicable and if lower 50 % of the mortgage lending value (MLV)) do not exceed 0,3 % of the outstanding loans collateralised by commercial real estate property in any given year; and

(b) overall losses stemming from lending collateralised by commercial real estate property must not exceed 0,5 % of the outstanding loans collateralised by commercial real estate property in any given year."

54. [unchanged]

55. The 50% risk weight shall be assigned to the Part of the loan that does not exceed a limit calculated in accordance to either of the following conditions:

(a) ~~50%~~ 40% of the market value of the property in question;

(b) 40% ~~50%~~ of the market value of the property or ~~60%~~ 50 % of the mortgage lending value, whichever is lower, in those Member States that have laid down rigorous criteria for the assessment of the mortgage lending value in statutory or regulatory provisions.";

(q) Points 57 to 60 are replaced by the following:

"57. When the ~~discretion contained~~ decision referred to in points~~ 51 to~~ 53a ~~exercised~~ has been taken positively by the competent authorities of one Member State, the competent authorities of another Member State may allow their credit institutions to risk weight at 50 % such exposures fully and completely secured by mortgages on commercial property.

58. ~~Competent authorities~~ Credit institutions may dispense with the condition contained in point 54(b) for exposures fully and completely secured by mortgages on commercial property which is situated within the ~~their~~ territory of a Member State, if the competent authority of that Member State has decided based on ~~they have~~ evidence that a well-developed and long-established residential real estate market is present in ~~their~~ that territory with loss rates which do not exceed the following limits:

(a) losses stemming from lending collateralised by commercial real estate property up to ~~5~~ 40 % of the market value (or where applicable and if lower ~~6~~ 50 % of the mortgage lending value (MLV)) do not exceed 0,3 % of the outstanding loans collateralised by commercial real estate property in any given year; and

(b) overall losses stemming from lending collateralised by commercial real estate property must not exceed 0,5 % of the outstanding loans collateralised by commercial real estate property in any given year.

59. If either of the limits referred to in point 58 is not satisfied in a given year, the eligibility to use point 58 shall cease and the condition contained in point 54(b) shall apply until the conditions in point 58 are satisfied in a subsequent year.

60. When the competent authority of a Member State has taken a positive decision in respect of the real estate market in the territory of that State in accordance with point 58, ~~the competent authorities~~ credit institutions in ~~of an~~other Member States may ~~allow their credit institutions to~~ assign a risk weight of 50 % to exposures fully and completely secured by mortgages on commercial property situated within that territory.";

(r) Point 63 is replaced by the following:

"63. Nonetheless, until 31 December 2012, where a past due item is fully secured by forms of collateral other than those eligible for credit risk mitigation purposes, a 100 % risk weight may be assigned subject to the discretion of competent authorities based upon strict operational criteria to ensure the good quality of collateral when value adjustments reach 15% of the exposure gross of value adjustments.";

(s) Point 64 is replaced by the following:

"64. 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. Until 31 December 2012, 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.";

(t) Point 66 is replaced by the following:

"~~Subject to the discretion of competent authorities,~~ ~~e~~Exposures that are associated with particularly high risks, including where appropriate ~~associated with particularly high risks such as~~ investments in venture capital firms, ~~and~~ private equity investments, speculative real estate programs and hedge funds, shall be assigned a risk weight of 150 % . When assessing whether an exposure is associated with particularly high risks, competent authorities shall, on the basis of CEBS guidelines, take into account the following risk characteristics:

(a) there is a high risk of loss as a result of a default of the obligor; or

(b) it is impossible to assess adequately whether the exposure falls under point (a).";

(u) In point 67, the introductory phrase is replaced by the following:

"Until 31 December 2012, 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:";

(v) Second sentence of point 68 (e) is replaced by the following:

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

(w) Point 78 is replaced by the following:

"78. ~~If a competent authority approves a third country CIU as eligible, as set out in point 77(a), then a competent authority in another Member State may make use of this recognition without conducting its own assessment.~~ Competent authorities shall allow their credit institutions to use a collective investment undertaking established in a third country provided that the conditions in point 77(a) are met. To this end, the Committee of European Banking Supervisors shall conduct an assessment of the supervisory and regulatory arrangements of the third country in question.";

(x) Point 85 is deleted.

18. In Annex VI, Part 3, point 17 is replaced by the following:

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

19. Annex VII, Part 1 is amended as follows:

(a) The second paragraph of point 6 is replaced by the following:

"The competent authorities ~~may~~ shall 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 competent authority is satisfied, on the basis of guidelines provided by the Committee of European Banking Supervisors, that the credit institution's underwriting characteristics and other risk characteristics are substantially strong for the relevant category.";

(b) The third paragraph of point 13 is replaced by the following:

"By way of derogation from point (b), ~~competent authorities~~ credit institutions may waive the requirement that the exposure be unsecured in respect of collateralised credit facilities linked to a wage account. In this case amounts recovered shall not be taken into account in the LGD estimate.";

(c) Point 18 is replaced by the following:

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

20. Annex VII, Part 2 is amended as follows:

(a) The second sentence of point 5 is replaced by the following:

"For dilution risk, however, on the basis of guidelines provided by the Committee of European Banking Supervisors, ~~competent authorities may recognise as eligible~~ unfunded credit protection providers other than those indicated in Annex VIII, Part 1 may be recognised as eligible. The competent authorities shall publish the list of those other eligible protection providers.";

(b) The fourth sentence of point 7 is replaced by the following:

"Competent authorities may recognise as eligible unfunded credit protection providers other than those indicated in Annex VIII, Part 1 as set out in point 5.";

(c) The last sentence of point 12 is replaced by the following:

"Member States shall provide that competent authorities may require ~~all~~ credit institutions in their jurisdiction to use maturity (M) for each exposure as set out under point 13.";

(d) The second paragraph of Point 14 is replaced by the following:

"In addition, for ~~other~~ the following short-term exposures ~~specified by the competent authorities~~ which are not p~~P~~art of the credit institution's ongoing financing of the obligor, M shall be at least one-day~~.~~:

Exposures to institutions arising from foreign exchange settlements;

Self-liquidating short-term trade financing transactions, import and export letters of credit and similar transactions with a residual maturity of up to one year;

Exposures arising from settlement of securities purchases and sales within the usual delivery period or two business days"; and

Exposures arising from cash settlements by wire transfer and settlements of electronic payment transactions and prepaid cost, including overdrafts arising from failed transactions that do not exceed a short, fixed agreed number of business days.

The Committee of European Banking Supervisors shall establish guidelines on the implementation of this provision. ~~A careful review of the particular circumstances shall be made in each case.~~";

(e) Point 15 is replaced by the following:

"15. ~~The competent authorities may allow for~~ 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 shall be used. Until 31 December 2012, competent authorities may replace EUR 500 million total assets with EUR 1000 million total assets for corporates which primarily invest in real estate.";

(f) Point 20 is replaced by the following:

"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, on the basis of guidelines established by the Committee of European Banking Supervisor, competent authorities may recognise as eligible unfunded protection providers other than those indicated in Annex VIII, Part 1. To this end, competent authorities shall publish the list of those other eligible protection providers together with the reasons why these are considered suitable for this purpose.";

(g) The following section number and heading is inserted is added:

"3.4. Mutual recognition and other provisions";

(h) The following points 28 and 29 are added:

"28. When the discretion contained in points 5, 7 and 20 is exercised by the competent authority of one Member State, the competent authorities of other Member States shall allow their credit institutions to use as eligible those unfunded credit protection providers recognised by that competent authority.

29. Pending further harmonisation, the Commission shall review the implementation of this provision by 31 December 2011.".

21. Annex VII, Part 4 is amended as follows:

(a) In point 44:

(i) the fifth paragraph is replaced by the following:

"Until 31 December 2012, in the case of retail exposures and exposures to public sector entities (PSE) the competent authorities shall set a number of days past due as specified in point 48.";

(ii) The seventh paragraph replaced by the following:

"In all cases, the exposure past due shall be above a threshold ~~defined by the competent authorities and which~~ reflecting a reasonable level of risk. The Committee of European Banking Supervisor shall establish guidelines on the determination of that threshold. Member States shall provide that the competent authorities may adapt this threshold in accordance with Article 84(2).";

(b) Point 48 is replaced by the following:

"48. Until 31 December 2012, for retail and PSE exposures, the competent authorities of each Member States shall set the exact number of days past due that all credit institutions in its jurisdiction shall abide by under the definition of defaults set out in §44, for exposures to such counterparts situated within this Member State. The specific number shall fall within 90-180 days and may differ across product lines.

Until 31 December 2012, for exposures to such counterparts situated in the territories of other Member States, the competent authorities shall set a number of days past due which is not higher than the number set by the competent authority of the respective Member State.";

(c) Point 56 is replaced by the following:

"56. Member States shall provide that, 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 shall allow, on the basis of guidelines established by the Committee of European Banking Supervisors, the credit institutions some flexibility in the application of the required standards for data.";

(d) Point 66 is replaced by the following:

"66. Irrespective of whether a credit institution is using external, internal, or pooled data sources, or a combination of the three, for its PD estimation, the length of the underlying historical observation period used shall be at least five years for at least one source. If the available observation period spans a longer period for any source, and this data is relevant, this longer period shall be used. This point also applies to the PD/LGD Approach to equity. ~~Member States may allow credit institutions~~ Subject to the approval of competent authorities, credit institutions which are not permitted to use own estimates of LGDs or conversion factors may ~~have~~ use, 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.";

(e) Point 71 is replaced by the following:

"71. Irrespective of whether a credit institution is using external, internal or pooled data sources or a combination of the three, for their estimation of loss characteristics, the length of the underlying historical observation period used shall be at least five years for at least one source. If the available observation spans a longer period for any source, and these data are relevant, this longer period shall be used. A credit institution need not give equal importance to historic data if it can convince its competent authority that more recent data is a better predictor of loss rates. ~~Member States may allow credit institutions to~~ Subject to the approval of competent authorities, credit institutions may use ~~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.";

(f) Point 86 is replaced by the following:

"86. Estimates of LGD shall be based on data over a minimum of five years. Notwithstanding point 73, a credit institution needs not give equal importance to historic data if it can demonstrate to its competent authority that more recent data is a better predictor of loss rates. ~~Member States may allow credit institutions to have~~Subject to the approval of competent authorities, credit institutions may use, 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.";

(g) Point 95 is replaced by the following:

"95. Estimates of conversion factors shall be based on data over a minimum of five years. Notwithstanding point 87, a credit institution need not give equal importance to historic data if it can demonstrate to its competent authority that more recent data is a better predictor of draw downs. ~~Member States may allow credit institutions to have~~ Subject to the approval of competent authorities, credit institutions may use, 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.".

22. In Annex VIII, Part 1 is amended as follows:

(a) Points 15 to 19 are replaced by the following:

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

16. ~~The competent authorities may waive the requirement for their c~~ Credit institutions ~~to comply~~ may dispense with condition (b) in point 13 for exposures secured by residential or commercial real estate property situated within the territory of a ~~that~~ Member State, if the competent authorityies of that Member State has decided on the basis of evidence that the relevant market is well-developed and long-established ~~with loss-rates which are sufficiently low to justify such action. This shall not prevent the competent authorities of a Member State, which do not use this waiver from recognising as eligible residential real estate property recognised as eligible in another Member State by virtue of the waiver. Member States shall disclose publicly the use they make of this waiver.~~

~~17. The competent authorities of the Member States may waive the requirement for their credit institutions to comply with the condition in point 13(b) for commercial real estate property situated within the territory of that Member State, if the competent authorities have evidence that the relevant market is well-developed and long-established~~ and that loss-rates stemming from lending secured by residential or commercial real estate property satisfy the following conditions:

(a) losses stemming from loans collateralised by residential or commercial real estate property up to ~~5~~ 40 % of the market value (or where applicable and if lower ~~6~~ 50 % of the mortgage-lending-value) do not exceed 0,3 % of the outstanding loans collateralised by that form of ~~commercial~~ real estate property in any given year; and

(b) overall losses stemming from loans collateralised by residential or commercial real estate property do not exceed 0,5 % of the outstanding loans collateralised by that form of ~~commercial~~ real estate property in any given year.

18. If either of the conditions mentioned in point 19 is not satisfied in a given year for a particular territory, point 19 shall to apply for exposures secured by residential or commercial real estate property which is situated within that territory until those conditions are satisfied in a subsequent year.

19. ~~The competent authorities of a Member State may recognise as eligible collateral commercial real estate property recognised as eligible collateral in another Member State by virtue of the waiver provided for in point 17.~~ When the competent authority of a Member State has taken a positive decision in respect of the relevant market in

the territory of that State in accordance with point 58,, credit institutions in ~~of an~~other Member States may recognise as eligible collateral those mortgages on residential or commercial property situated within that territory.";

(b) Point 20 is replaced by the following:

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

(c) Point 21 is replaced by the following:

"21. The competent authorities ~~may~~ shall recognise as eligible collateral physical items of a type other than those types indicated in points 13 to 19 if satisfied as to the following:

(a) the existence of liquid markets for the disposal of the collateral in an expeditious and economically efficient manner. In case of moveable assets, this condition need not to be assessed only with respect to the local market. The institution must be able to demonstrate that the relevant market for the collateral is sufficiently liquid. Criteria relevant to the fulfilment of this condition shall include the frequency of the transactions made in the relevant market. The assessment of this condition shall be reviewed when information indicates that the quantity of transactions or the collateral prices may have declined materially; ~~and~~

(b) the existence of well-established publicly available market prices for the collateral. The market prices may be considered well-established if they come from reliable sources of information such as public indexes and reflect the price of the transactions under normal conditions. To be considered publicly available, these prices must be disclosed, easily accessible, and obtainable regularly and without any undue administrative or financial burden; and

(c) ~~Tthat~~ the credit institution has analysed the empirical evidence, including the market prices, time required to realise the collateral and the recovery rates. The credit institution must be also able to demonstrate that there is no evidence that the net prices it receives when the assets taken as collateral are ~~is~~ realised deviate~~s~~ significantly from these market prices. The fulfilment of these requirements and those specified in Annex VIII, Part 2, point 10 must be sufficiently documented. In case of material volatility in the market prices, the institution must be able to demonstrate that its valuation of the collateral is sufficiently conservative.";

(d) Point 28 is replaced by the following:

"28. ~~By way of derogation from point 26~~, ~~Member~~ The competent authorities shall also recognise as eligible providers of unfunded credit protection, other financial institutions authorised and supervised by the competent authorities responsible for the authorisation and supervision of credit institutions and subject to prudential requirements equivalent to those applied to credit institutions. The competent authorities shall publish the list of those other eligible protection providers together with a description of the applicable prudential requirements.".

23. In Annex VIII, Part 2, Point 9(a)(ii) is replaced by the following:

"(ii) Credit institutions must take all steps necessary to fulfil local requirements in respect of the enforceability of security interest. There shall be a framework which allows the lender to have a first priority claim over the collateral subject to national discretion to allow such claims to be subject to the claims of preferential creditors provided for in legislative or implementing provisions. When this national discretion is exercised by one Member State, other Member States shall allow their credit institutions to treat as a first priority claim a security interest in that Member State, subject to those claims of preferential creditors'."

24. Annex VIII, Part 3 is amended as follows:

(a) Point 12 is replaced by the following:

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

(b) Point 19 is replaced by the following:

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

(c) Point 43 is replaced by the following:

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

(d) Point 59 is deleted;

(e) Points 73 to 75 are replaced by the following:

"73. Subject to the requirements of this point and point 74 and as an alternative to the treatment in points 68 to 72, the ~~competent authorities of a Member State may authorise~~ credit institutions may ~~to~~ assign a 50 % risk weight to the Part of the exposure that is, within the limits of Annex VI Part 1, points 48 (d) and 55 respectively, fully collateralised by residential real estate property or commercial real estate property situated within the territory of a ~~the~~ Member State if the~~y~~ competent authority of that Member State has decided based on ~~have~~ evidence that the relevant markets are well developed and long-established with loss-rates from lending collateralised by residential real estate property or commercial real estate property respectively that do not exceed the following limits:

(a) losses stemming from lending collateralised by residential real estate property or commercial real estate property respectively up to 40% ~~50 %~~ of the market value (or where applicable and if lower 50% ~~60 %~~ of the mortgage-lending-value) do not exceed 0,3 % of the outstanding loans collateralised by that form of real estate property in any given year; and

(b) overall losses stemming from lending collateralised by residential real estate property or commercial real estate property respectively do not exceed 0,5 % of the outstanding loans collateralised by that form of real estate property in any given year.

74. If either of the conditions in point 73 is not satisfied in a given year, the eligibility to use this treatment shall cease until the conditions are satisfied in a subsequent year.

75. ~~The competent authorities, which do not authorise the treatment in point 73, may authorise c~~ Credit institutions may ~~to~~ assign the risk weights permitted under this treatment in respect of exposures collateralised by residential real estate property of commercial real estate property respectively located in the territory of those Member States the competent authorities of which have taken a positive decision in accordance with point 73 ~~authorise this treatment subject to the same conditions as apply in that Member State~~.";

(f) Point 89 is replaced by the following:

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

25. Annex IX, Part 4 is amended as follows:

(a) Point 30 is replaced by the following:

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

(b) Point 31 is deleted;

(c) Last paragraph of point 53 is replaced by the following:

"For securitisations involving retail exposures, ~~the competent authorities may permit~~ the Supervisory Formula Method ~~to be implemented~~ using the simplifications: h=0 and v=0, provided that the institution applies this approach consistently.".

26. Point 3 of Annex X, Part 2 is replaced by the following:

"3. ~~Competent authorities may authorise a credit institution to calculate its capital requirement for operational risk using an alternative standardised approach, as set out in points 5 to 11.~~ For certain business lines, credit institutions may use an alternative relevant indicator for determining their capital requirement for operational risk as set out in Annex X, Part 2, points 5 to 11 if the relevant competent authorities approve that the conditions there specified are met.".

27. Point 11 of Annex X, Part 3 is replaced by the following:

"11. Correlations in operational risk losses across individual operational risk estimates shall ~~may~~ be recognised only if credit institutions can demonstrate to the satisfaction of the competent authorities that their systems for measuring correlations are sound, implemented with integrity, and take into account the uncertainty surrounding any such correlation estimates, particularly in periods of stress. The credit institution must validate its correlation assumptions using appropriate quantitative and qualitative techniques. The Committee of European Banking Supervisors shall establish guidelines on all supervisory decisions taken by the competent authorities to implement this Directive with a view to ensuring the convergence of supervisory practices.".

Below are presented the areas in which options and national options will be removed from Directive 2006/48/EC.

1. Article 18 is amended as follows:

   (a) The introductory phrase in paragraph 2 is replaced by the following:

   "2. By way of derogation from paragraph 1, ~~the competent authorities may allow~~ institutions may ~~to~~ calculate the capital requirements for their trading book business in accordance with Article 75(a) of Directive 2006/48/EC and points 6, 7, and 9 of Annex II to this Directive, where the size of the trading book business meets the following requirements:";

   (b) Paragraph 3 is replaced by the following:

   "3. In order to calculate the proportion that trading-book business bears to total business for the purposes of points (a) and (c) of paragraph 2, institutions ~~the competent authorities~~ may refer either to the size of the combined on- and off-balance-sheet business, to the profit and loss account or to the own funds of the institutions in question, or to a combination of those measures. When the size of on- and off-balance sheet business is assessed, debt instruments shall be valued at their market prices or their principal values, equities at their market prices and derivatives according to the nominal or market values of the instruments underlying them. Long positions and short positions shall be summed regardless of their signs. The Commission shall review the implementation of this provision by 31 December 2011.".

2. Article 19 is amended as follows:

   (a) Paragraph 2 is replaced by the following:

   "2. By way of derogation from points 13 and 14 of Annex I, ~~Member States~~ credit institutions may calculate the ~~set a~~ specific risk requirement for ~~any~~ bonds falling within points 68 to 70 of Part 1 of Annex VI to Directive 2006/48/EC as 8% of the risk-weighted exposure amounts or applying a weighting of 8% of the risk weight, as applicable in the same institution's non-trading book ~~which shall be equal to the specific risk requirement for a qualifying item with the same residual maturity as such bonds and reduced in accordance with the percentages given in point 71 of Part 1 to Annex VI to that Directive~~.";

   (b) Paragraph 3 is replaced by the following:

   "3. ~~If, as set out in point 52 of Annex I, a competent authority approves a third country's collective investment undertaking (CIU) as eligible, a competent authority~~

~~in another Member State may make use of this approval without conducting its own assessment.~~ Competent authorities shall allow credit institutions to use a collective investment undertaking established in a third country provided that the requirements in points (a) to (e) of point 51 of Annex I are met. To this end, the Committee of European Banking Supervisors shall conduct an assessment of the supervisory and regulatory arrangements of the relevant third country.".

3. Article 20 is amended as follows:

   (a) The introductory phrase in paragraph 2 is replaced by the following:

   "2. By way of derogation from paragraph 1, ~~competent authority may allow~~ investment firms that are not authorised to provide the investment services listed in points 3 and 6 of Section A of Annex I to Directive 2004/39/EC ~~to~~ may provide own funds which are always more than or equal to the higher of the following:";

   (b) The introductory phrase in paragraph 3 is replaced by the following:

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

4. Article 24 is amended as follows:

   (a) The first paragraph is replaced by the following:

   'By way of derogation from Article 2(2), ~~competent authorities may exempt~~ an investment firm may choose not to apply ~~from~~ the consolidated capital requirement established in that Article, provided that all the investment firms in the group are covered by Article 20(2) and the group does not include credit institutions.";

   (b) The introductory phrase in the second paragraph is replaced by the following:

   "Where ~~the requirements of~~ option in paragraph 1 is used ~~are met~~,";

   (c) The introductory phrase in the third paragraph is replaced by the following:

   "Where ~~the requirements of~~ option in paragraph 1 is used ~~are met~~,".

5. Article 25 is amended as follows:

   (a) The first paragraph is replaced by the following:

   "By way of derogation from Article 2(2), ~~competent authorities may exempt~~ an investment firm may choose not to apply ~~from~~ the consolidated capital requirement established in that Article, provided that all the investment firms in the group fall within the investment firms referred to in Article 20(2) and (3), and the group does not include credit institutions.";

   (b) The introductory phrase in the second paragraph is replaced by the following:

   "Where ~~the requirements~~ the option in the first paragraph is used ~~are met~~,";

(c) The introductory phrase in the third paragraph is replaced by the following:

Where ~~the requirements~~ the option in the first paragraph is used ~~are met~~,".

6. Article 33(3) is deleted.

7. Annex I is amended as follows:

(a) In point 4, the second paragraph is deleted;

(b) In point 5, the second paragraph is deleted;

(c) In point 5, the third paragraph is replaced by the following:

"Other risks, apart from the delta risk, associated with options shall be safeguarded against. ~~The competent authorities may allow the requirement against a written exchange-traded option to be equal to the margin required by the exchange if they are fully satisfied that it provides an accurate measure of the risk associated with the option and that it is at least equal to the capital requirement against an option that would result from a calculation made using the method set out in the remainder of this Annex or applying the internal models method described in Annex V. The competent authorities may also allow the capital requirement for an OTC option cleared by a clearing house recognised by them to be equal to the margin required by the clearing house if they are fully satisfied that it provides an accurate measure of the risk associated with the option and that it is at least equal to the capital requirement for an OTC option that would result from a calculation made using the method set out in the remainder of this Annex or applying the internal models method described in Annex V. In addition they may allow the requirement on a bought exchange-traded or OTC option to be the same as that for the instrument underlying it, subject to the constraint that the resulting requirement does not exceed the market value of the option. The requirement against a written OTC option shall be set in relation to the instrument underlying it.~~";

(d) In point 14, the next to last paragraph is replaced by the following:

"Instruments issued by a non-qualifying issuer shall receive a specific risk capital charge of 8% or 12 % according to Table 1. ~~Competent authorities may require institutions to apply a higher specific risk charge to such instruments and/or to disallow offsetting for the purposes of defining the extent of general market risk between such instruments and any other debt instruments.~~";

(e) Point 26 is replaced by the following:

"26. ~~The competent authorities may allow institutions in general or on an individual basis to~~ Institutions may use a system for calculating the capital requirement for the general risk on traded debt instruments which reflect duration, instead of the system set out in points 17 to 25, provided that the institution does so on a consistent basis.";

(f) Point 52 is replaced by the following:

"52. Third country CIUs ~~may~~ shall be eligible if the requirements in points (a) to (e) of point 51 are met, subject to the ~~to the approval of the institution's competent authority~~ process defined in Article 19.3.".

8. Annex III is amended as follows:

(a) In point 2.1, the last sentence is replaced by the following:

"~~The competent authorities shall have the discretion to allow institutions to~~ An institution may use the net present value when calculating the net open position in each currency and in gold provided that the institution applies this approach consistently.";

(b) In point 3.1, the first two sentences are replaced by the following:

"~~The competent authorities may allow i~~ Institutions may ~~to~~ provide lower capital requirements against positions in closely correlated currencies than those which would result from applying points 1 and 2 to them. ~~The competent authorities may deem~~ A pair of currencies is deemed to be closely correlated only if the likelihood of a loss — calculated on the basis of daily exchange-rate data for the preceding three or five years — occurring on equal and opposite positions in such currencies over the following 10 working days, which is 4 % or less of the value of the matched position in question (valued in terms of the reporting currency) has a probability of at least 99 %, when an observation period of three years is used, or 95 %, when an observation period of five years is used.".

9. Annex IV is amended as follows:

(a) In point 7, the introductory phrase is replaced by the following:

"7. ~~The competent authorities may regard the following positions as positions in the same commodity:~~ For the purposes of calculating a position in a commodity, the following positions shall be treated as positions in the same commodity:";

(b) In point 8, the second and the third paragraphs are deleted;

(c) In point 10, the second paragraph is deleted;

(d) In point 10, the last three paragraphs are deleted;

(e) In point 14, the introductory phrase is replaced by the following:

"14. ~~Competent authorities may allow p~~ Positions which are, or are regarded pursuant to point 7 as, positions in the same commodity may be offset and assigned to the appropriate maturity bands on a net basis for the following:".

ANNEX 4

RELEVANT TEXT OF THE BANK BRANCH ACCOUNTS DIRECTIVE

Article 2 - Provisions relating to branches of credit institutions and financial institutions having their head offices in other Member States

1. Member States shall require branches of credit institutions and financial institutions having their head offices in other Member States to publish, in accordance with Article 44 of Directive 86/635/EEC, the credit institution or financial institution documents referred to therein (annual accounts, consolidated accounts, annual report, consolidated annual report, opinions of the person responsible for auditing the annual accounts and consolidated accounts).

2. Such documents must be drawn up and audited in the manner required by the law of the Member State in which the credit institution or financial institution has its head office in accordance with Directive 86/635/EEC.

3. Branches may not be required to publish annual accounts relating to their own activities.

~~4. Member States may, pending further coordination, require branches to publish the following additional information:~~

- ~~the income and costs of the branch deriving from items 1, 3, 4, 6, 7, 8 and 15 of Article 27 or from items A.4, A.9, B.1 to B.4 and B.7 of Article 28 of Directive 86/635/EEC,~~
- ~~the average number of staff employed by the branch,~~
- ~~the total claims and liabilities attributable to the branch, broken down into those in respect of credit institutions and those in respect of customers, together with the overall amount of such claims and liabilities expressed in the currency of the Member State in which the branch is established,~~
- ~~the total assets and the amounts corresponding to items 2, 3, 4, 5 and 6 of the assets, 1, 2 and 3 of the liabilities and 1 and 2 of the off-balance sheet items defined in Article 4 and parallel Articles of Directive 86/635/EEC, and, in the case of items 2, 5 and 6 of the assets, a breakdown of securities according to whether they have or have not been regarded as financial fixed assets pursuant to Article 35 of Directive 86/635/EEC.~~

~~Where such information is required, its accuracy and its accordance with the annual accounts must be checked by one or more persons authorized to audit accounts under the law of the Member State in which the branch is established.~~

Article 3 - Provisions relating to branches of credit institutions and financial institutions having their head offices in non-members countries

1. Member States shall require branches of credit institutions and financial institutions having their head offices in non-member countries to publish the documents specified in Article 2 (1), drawn up and audited in the manner required by the law of the country of the head office, in accordance with the provisions set out therein.

2. Where such documents are in conformity with, or equivalent to, documents drawn up in accordance with Directive 86/635/EEC and the condition of reciprocity, for Community credit institutions and financial institutions, is fulfilled in the non-member country in which the head office is situated, Article 2 (3) shall apply.

3. In cases other than those referred to in paragraph 2, Member States may require the branches to publish annual accounts relating to their own activities.

4. In the cases specified in paragraphs 2 and 3, Member States may require branches to publish the information referred to in Article 2 (4) and the amount of the endowment capital.

5. Article 9 (1) and (3) of Directive 77/780/EEC shall apply by analogy to branches of credit institutions and financial institutions covered by this Directive.

Article 4 Language of publication

Member States may require that the documents provided for in this Directive be published in their official national language or languages and that translations thereof be certified.