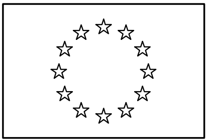

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COMMISSION STAFF WORKING PAPER

Proposal for a Directive of the European Parliament and of the Council relating to the taking up and pursuit of the business of credit institutions (recast)

Proposal for a Directive of the European Parliament and of the Council on the capital adequacy of investment firms and credit institutions (recast)

Extended Impact Assessment

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1. INTRODUCTION TO THE INTERNATIONAL REGULATION OF FINANCIAL INSTITUTIONS BY MEANS OF MINIMUM CAPITAL REQUIREMENTS AND THE SINGLE MARKET FOR FINANCIAL INSTITUTIONS IN THE EU

1.1. The international regulation of financial institutions by means of minimum capital requirements

Credit institutions and investment firms (collectively 'financial institutions') play a crucial role in the efficient functioning of the economy and their activities support the material and social wellbeing of citizens. They are risk-focused entities and subject to the risk of failure. Such failures can result in significant negative impact – both on the economy and on the wellbeing of large numbers of individual citizens. The costs of failure are, from the perspective of financial institutions, an external cost. A key purpose of the regulation of financial institutions is to achieve the internalisation of such costs and to ensure that financial institutions operate at a level of soundness which, while not excluding the risk of failure, represents an appropriate standard having regard to its social costs.

In the course of the last 25 years regulation of financial institutions has seen a progressive reduction in structural regulation[1] and a progressive adoption of tools of prudential regulation[2]. The main reason for this is that the costs for society implied by a lack of competition due to structural regulation have induced policymakers to introduce new (prudential) regulatory tools which are compatible with a higher degree of competition between banks.

The prudential regulatory tool which has gradually come to dominate in the international scenario to limit the risks taken by financial institutions when they select and monitor investments and more generally engage in risk-taking activities are minimum capital requirements (MCR), which are minimum levels of capital a financial institution must satisfy having regard to the risks to which it is exposed. Minimum capital requirements are designed to ensure that financial institutions have sufficient resources of their own to absorb the losses which it can reasonably be envisaged may arise as a result of their risk-taking activities and, in a worst case scenario, that they have sufficient resources for an orderly wind-down of the institution in case of failure. They form part of a broader policy mix in which other key aspects are the development of appropriate risk monitoring and evaluation functions in financial institutions and the supervision by competent authorities of financial institutions on an ongoing basis.

MCR have become a central tool of financial institutions prudential regulation with the agreement by the Basel Committee on Banking Supervision[3] of the so-called Basel Accord in

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1 Structural regulation tools are those by which regulators model directly the structure and the behaviour of supervised entities. Examples of structural regulation are the central planning of branches and the imposition of limits on the remuneration of deposits.

2 Examples of prudential regulation are minimum capital requirements, limits to large exposures, quality controls and processes.

3 The Basel Committee on Banking Supervision was established by the central bank Governors of the Group of Ten (G-10) countries. For further information, see further section 4.1.

1988, also referred to as Basel I. This accord led to the adoption of minimum capital requirements across over 100 countries.[4]

The agreement of the Basel I Accord was broadly contemporaneous to the adoption of key EU directives in the field of prudential regulation of credit institutions. The Council Directive 89/299/EEC of 17 April 1989 on the own funds of credit institutions (Own Funds Directive) harmonized the definitions of own funds for all credit institutions in the EU to ensure the comparability of capital needed to comply with minimum capital requirements of EU credit institutions. The Council Directive 89/647/EEC of 18 December 1989 on a solvency ratio for credit institutions (Solvency Ratio Directive) implemented by means of law the contents of the Basel I Accord to the banking system of the European Union, harmonizing minimum capital requirements for credit institutions in the EU given the definitions laid down in the Own Funds Directive. These directives have, with others, been consolidated in the Directive 2000/12/EC of the European Parliament and of the Council of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions (Consolidated Banking Directive - CBD).

The directives mentioned above addressed credit institutions' risks arising from their credit-granting activities. The Council Directive 93/6/EEC of 15 March 1993 on the capital adequacy of investments firms and credit institutions (Capital Adequacy Directive - CAD) extended the framework to a further key set of risks – those arising from institutions trading activities (known as 'market risks'). The CAD also extended both the credit risk and market risk rules to investment firms.

1.2. The single market for financial institutions in the EU and the FSAP

The European Institutions have since the beginning of the 80s favoured an increase in competition in financial services by means of the creation of an integrated internal and single market for financial institutions. An important spur for this policy came from the Cecchini Report, a study commissioned by the European Commission from Price Waterhouse, which was asked to estimate the advantages coming from completion of the single market in 1992. The Report indicated that about one third of the advantages which could be expected from the completion of the Single Market could come from the integration of the European financial and banking system.

The Second Council Directive 89/646/EEC of 15 December 1989 on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions introduced the principle of the single licence for credit institutions in the EU. This principle was the cornerstone of the strategy for liberalising banking services in the EU, as it allowed the free provision of banking services eliminating the need to obtain a local banking charter from host country supervisors for branches and products permitted in the home country.

In the attempt to finalise the process leading to a single market for financial services started during the 80s, the European Council instructed the Commission to prepare a policy framework for financial services at its meeting in Cardiff in 1998. A series of policy objectives and specific measures to improve the Single Market for financial services over the

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[4] While formally agreed by the authorities of the G-10 group of industrialised countries for application to internationally active banks, the 1988 Basel I Accord has been applied throughout the world to banks of all sizes and levels of complexity.

following five years was outlined in an Action Plan adopted by the European Commission on 11 May 1999[5]. The Action Plan suggested indicative priorities and time-scales for legislative and other measures to tackle three strategic objectives, namely ensuring a Single Market for wholesale financial services, open and secure retail markets and state-of-the-art prudential rules and supervision.

Under strategic objective 3, state-of-the-art prudential rules and supervision, it is indicated that urgent headway had to be made in particular in order to:

- Eliminate any lacunae in the EU prudential framework, arising from new forms of financial business or globalisation, as a matter of utmost urgency.
- Set rigorous and appropriate standards so that the EU banking sector can successfully manage intensification of competitive pressures.
- Contribute to the development of EU supervisory structures which can sustain stability and confidence in an era of changing market structures and globalisation.
- Develop a regulatory and supervisory approach which will serve as the basis for successful enlargement.
- Enable the EU to assume a key role in setting high global standards for regulation and supervision, including financial conglomerates.

Within these objectives, one of the actions of the Financial Services Action Plan (FSAP) was identified as amending the directives governing the capital framework for banks and investment firms.

2. THE NEED FOR REVISED PRUDENTIAL STANDARDS IN THE EU

2.1. The main shortcomings of the existing framework

One essential aspect of financial regulation are prudent capital adequacy provisions which aim to ensure that credit institutions and investment firms hold capital that is proportionate to the nature and scale of the risks that they undertake. It has been mentioned in the previous section that the existing EU capital framework is mainly based on the CBD and the CAD. These directives have made a significant contribution to the establishment of the single market and to high prudential standards.[6] However, a number of shortcomings with respect to the present capital regime have been identified.

- *1. Crude estimates of banks' credit risks:* Capital rules are based on a technique known as 'risk weighting'. This means that an exposure is assigned a risk weight – e.g. 10%, 20%, 50%, 100% - depending upon the perceived level of risk. This percentage is then applied to

[5] The *Financial Services: Implementing the framework for financial markets: Action Plan*, COM(1999) 232 can be found on http://europa.eu.int/comm/internal_market/en/finances/actionplan/index.htm.

[6] Present EU MCR for credit risk are closely modelled on the Basel I Accord of 1988. Thorough research by the Basel Committee pointed out how data on the capital ratios of G-10 banks indicate that the introduction of the Basel Accord was followed by an increase in risk-weighted capital ratios in a number of countries. The average ratio of capital to risk-weighted assets of major banks in the G-10 rose from 9.3% in 1988 to 11.2% in 1996.

the amount of the exposure to produce a 'risk weighted exposure amount'. The ultimate capital charge is 8% of this risk weighted exposure amount. However, the current risk weighting of assets results in an extremely crude measure of economic risk, primarily because degrees of credit risk exposure are not sufficiently calibrated as to adequately differentiate between borrowers' different default risks. There are for example only six different 'risk weight buckets'. For this reason, the actual structure of MCR impose on credit institutions a suboptimal financial structure and is in danger of falling into disrepute.

- *2. Scope for capital arbitrage:* The crude risk weight buckets in the current rules create a significant mismatch between financial institutions' own mode of allocation of capital to risks and the minimum capital they have to hold in virtue of regulation. Increasingly, innovations in the market have enabled financial institutions from a variety of countries to make use of techniques to effectively arbitrage between these differences, with a resulting increase in levels of risk relative to minimum capital requirements levels. One technique considered to be a potential vehicle for this is securitisation, although it should be emphasised that other factors different from capital arbitrage are very important drivers behind securitisation.

- *3. Lack of recognition of effective risk mitigation:* The present framework does not provide appropriate levels of recognition for risk mitigation techniques. This means that the recognition of collateral, guarantees and credit derivatives is at the moment unduly limited.

- *4. Incompleteness of the risks covered by current MCR:* The present prudential framework is focused largely on credit risks and market risks. However, there is a range of other risks, including in particular operational risk, which currently are not subject to any explicit capital charge. Operational risk is a significant risk faced by financial institutions the explicit inclusion of which in capital requirements rules is necessary to reinforce the stability and soundness of the financial system.

- *5. Lack of incentives for banks to develop improved internal risk management functions:* The capital requirements rules of the existing framework, being based on crude risk indicators, do not encourage financial institutions to develop and improve their processes and techniques for the measurement and management of risks.

- *6. Absence of a harmonised supervision requirement:* The current rules omit entirely a key aspect necessary to achieve adequate levels of capitalisation. That is the requirement that supervisory authorities evaluate the actual risk profile of credit institutions to satisfy themselves that adequate capital is held having regard to that risk profile.

- *7. Absence of an adequate supervisory cooperation requirement:* In an increasingly cross-border EU market it is necessary for both the proportionality of regulatory and supervisory burdens on institutions and for the competitiveness of the EU financial services sector that Member State supervisory authorities cooperate effectively with each other in the supervision of cross-border groups. The current rules need to be improved to produce the levels of cooperation in this regard necessary to the effective functioning of the EU internal market in financial services.

- *8. Absence of proper market disclosures:* The CBD and the CAD do not facilitate effective market discipline as a lever to strengthen the safety and soundness of the financial system. Effective market discipline requires reliable and timely information that enables market participants to make well-founded risk assessments.

- 9. *Lack of flexibility in the regulatory framework:* The current capital adequacy regulatory system in the EU lacks the flexibility needed to keep pace with rapid developments in financial markets and risk management practices, and with improvements in regulatory and supervisory tools.

2.2. What would happen under a "no policy change" scenario?

In light of the above, it is clear that there is a pressing need for the modernisation of the harmonised rules on the regulation of credit institutions and investment firms. There is wide and strong consensual view that the present situation is unsustainable, given that the present directives fail to capture the full extent or nature of the risks that some institutions are undertaking; that new risk management techniques are not actively encouraged or recognised; and that the framework may even lead to a misallocation of resources or significant capital arbitrage.

In the absence of a revision of the present regime for capital requirements in Europe:

- financial institutions' activities would keep being imposed a misallocation of resources and/or a suboptimal financial structure;

- capital requirements and risks would continue to be misaligned resulting in limited effectiveness of the rules on MCR;

- significant capital arbitrage would continue and would increase, with likely serious consequences to the economic and social objectives at which prudential regulation is aimed;

- the full extent or nature of the risks that some financial institutions are undertaking would keep not being captured by the present requirements;

- the most sophisticated and most effective risk management techniques would not be actively encouraged or recognised;

- financial services groups operating in more than one Member State would continue to be subject to disproportionate burdens resulting from multiple layers of regulation and supervision;

- market forces would keep not being leveraged to strengthen the safety and the soundness of the financial system;

- the EU would be unable to benefit appropriately from future developments in financial markets and in institutions' risk management practices or from improvements in regulatory or supervisory tools, given the difficulty in speedily updating the current EU regulatory framework;

- in view of the proposed global implementation of the new Basel Accord at end-2006 (referred to as 'Basel 2', see section 4.1), the EU financial services sector would be significantly disadvantaged as compared with its overseas competitors.

3. THE MAIN POLICY OBJECTIVES

Having considered the current shortcomings affecting the EU regulatory capital regime (see section 2) and after wide-ranging consultations with Member States and interested parties (see section 8), the Commission services formulated the following guiding objectives for the work on capital adequacy.

3.1. Objective 1: Provide the EU with a state-of-the-art prudential standards framework to increase the soundness and the stability of the EU financial system

EU regulatory safeguards need to keep pace with new sources of financial risk and state-of the-art supervisory practice in order to contain systemic or institutional risk. The highest standards of prudential regulation of capital adequacy are essential for both financial stability and the smooth functioning of the internal market for financial services. The European Union has to make sure that these standards:

- are kept up to date with market developments;
- accurately reflect the risks run by banks and investment firms operating within the EU;
- ensure no deterioration in the overall levels of capital;
- achieve appropriate consistency with the international framework on capital requirements;
- take account of the specific features of the EU context.

Such overall objective has been, on the basis of the shortcomings existing in the present framework, been specified more in detail in the following:

Sub-objective 1: ensure that the economic risk of financial transactions is better captured by capital charges and address the first shortcoming of the existing situation which allows only crude estimates of institutions' risks;

Sub-objective 2: prevent capital arbitrage practices by financial institutions addressing the second shortcoming of the existing situation which gives scope for circumventing capital adequacy rules;

Sub-objective 3: introduce in capital regulation an adequate recognition of risk mitigation techniques and address the third shortcoming of the existing situation where such recognition lacks almost completely;

Sub-objective 4: ensure that the full range of risks of banks are captured by the capital adequacy framework and address the fourth shortcoming of the existing situation which presents an important incompleteness in the risks covered by minimum capital requirements;

Sub-objective 5: provide incentives for the development of internal risk management functions and address the fifth shortcoming of the existing situation where such incentives lack almost completely;

Sub-objective 6: ensure that supervisory authorities evaluate the actual risk profile of credit institutions to satisfy themselves that adequate capital is held having regard to that risk profile;

Sub-objective 7: ensure that Member State supervisory authorities cooperate effectively with each other in the supervision of cross-border groups;

Sub-objective 8: leverage on market forces to strengthen the safety and soundness of the banking system and address the shortcoming of the present situation where proper market disclosures are almost absent;

Sub-objective 9: allow European credit institutions and investment firms to respond quickly to market change by introducing elements of flexibility in the EU capital adequacy regulatory framework.

3.2. Objective 2: Provide a proportionate capital treatment

The new capital requirements framework should be proportionate and recognise the variations in risks arising from the context in which exposures to different types of borrowers are incurred. In particular, recognition should be given to the reduction in risks stemming from situations where the credit institution has a large number of relatively small exposures to separate counterparties. This occurs particularly in the context of lending to consumers and to small- or medium-sized entities. Recognition of this effect in the capital requirements rules will provide a proportionate and prudentially sound treatment of exposures to such counterparties.

3.3. Objective 3: Provide an appropriate treatment for investment firms and investment services

In order to maintain and enhance a level playing field in the single market, the new capital requirements regime must apply in the EU to both credit institutions and investment firms, as ensuring an equal treatment of these institutions is a major policy concern. At the same time, the Commission believe that EU rules need to be proportionate and to take fully into account the 'biodiversity' of different financial institutions. This requires appropriate adaptation of the general rules.

4. THE MAIN POLICY OPTION TO REACH THE OBJECTIVES

4.1. The importance of the Basel process

The Basel Committee on Banking Supervision was established by the central bank Governors of the Group of Ten (G-10) countries. It consists of representatives of the central bank, and of the authority responsible for prudential supervision of banks where this is not the central bank, from the following countries: Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom and the United States. The European Commission, along with the European Central Bank, is an observer at the Committee and participates in the task forces and working groups focused on the capital review.

The importance of the Basel Committee rises in the context of how the globalisation of financial activity makes it essential that there is a global approach to prudential standards.

Without such a global approach there would be in fact the twin dangers of competition in laxity and regulatory arbitrage. Competition in laxity occurs when jurisdictions consciously lower regulatory prudential requirements to attract business. And regulatory arbitrage is the other side of this coin - the search by financial institutions for jurisdictions in which the burden of prudential regulation is lightest.

In the absence of a single world financial authority, with powers to set and enforce prudential regulations worldwide, the Basel Committee on Banking Supervision has emerged as the standard-setting body in which prudential standards are agreed by supervisors in the most advanced jurisdictions, while broader adoption is encouraged by peer pressure and market forces.

The existence of an international framework governing regulatory capital requirements has brought and will continue to bring significant benefits to the global economy as a whole. In particular, the new Basel II Accord will be a central contribution to a sound and stable global financial system, enhancing the resilience of the banking system in the face of adverse events. It will facilitate an international level playing field which will help prevent the benefits of competition from being undermined by regulatory arbitrage. And it will promote the efficiencies that result from having similar prudential standards in force throughout the world.

4.2. The three main options available to the EU

Having the context of the Basel process described above in the background, there are three main options available to the Commission in order to achieve the three aforementioned policy objectives.

4.2.1. The "Basel only" option

In the "Basel only" option, no action is taken at the EU level to revise the existing prudential standards framework and banks apply voluntarily the new Basel II accord on the basis of indications by their regulator and / or supervisor. At the same time banks would continue to apply the EU framework derived from Basel I as prescribed in the CBD and in the CAD.

This option has the benefit of minimizing the workload for EU institutions, but creates a series of very undesirable consequences. First, it does not promote financial stability in the EU as it does not foster the adoption by banks of the most advanced risk management and control methods. Second, it obliges de facto banks acting at the international level to apply a double set of prudential standards, with an important additional regulatory burden. Third, it does not respond to the development of globally agreed prudential standards among supervisors which reflect EU needs and perspectives. Fourth, it puts EU financial institutions at a competitive disadvantage vis à vis their international competitors as they would not be able to benefit from any reduction in capital requirements deriving from the new set of rules.

For the above reasons the "Basel only" option has not been retained by the Commission services as a possible working method in developing the new prudential standards framework.

4.2.2. The "EU only" option

In the "EU only" option, action is taken at the EU level without a close link with the work done by the Basel Committee. The results of the discussions at the EU level would be translated into a new EU prudential framework.

This option presents the theoretical advantage of developing a framework tailored on the specificities of the EU financial system, and of ensuring a fully-fledged discussion at all moments of the development of the new rules with all Member States. However, it also presents a series of very serious drawbacks. First, it duplicates the work by EU regulators and supervisors involved in the Basel process. Second, it leads to the creation of double prudential standards for EU banks acting at the international level which would be subject to two completely different sets of rules: those imposed in the EU and those agreed by supervisors in Basel. Third, it does not allow the creation of a level playing field between the EU and the other major actors of the global financial system, such as the US, Japan and Canada.

For the above reasons the “EU only” option has not been retained by the Commission services as a possible working method in developing the new capital requirements framework.

4.2.3. The “Basel and EU” option

In the “Basel and EU” option, action is taken at the EU level in parallel with the Basel process. Discussions are held at the same time in Basel and in the EU. While the new rules on capital adequacy are agreed by supervisors in Basel, at the same time the development of the discussions is presented in the EU to all Member States so that EU interests and points of convergence can be identified on specific issues and agreed if possible in Basel. If however the EU presents the need to pursue a line which can not be agreed in Basel on selected topics, such a line can still be pursued in the EU.

This option has the disadvantage of particularly heavy procedures to make sure that all Member States are informed of the discussions in Basel. It has also the disadvantage that not all Member States are present at the negotiations in Basel. It presents however a series of very important advantages. First, it allows the creation – except for specific topics – of a globally agreed prudential framework which ensures a worldwide level playing field in the financial system. Second, it allows the EU to benefit from the discussions in Basel without the need to replicate an important amount of technical work in order to ensure that the EU financial institutions are subject to a state-of-the-art prudential framework. Third, it allows the EU to influence the Basel process and to arrive at the creation of a broadly single prudential framework (in Basel and in the EU) for European financial institutions with an important limitation in the regulatory burdens they have to sustain. Fourth, it provides the EU with a sufficiently flexible framework for necessary departures from the Basel agreed solutions whenever strong EU reasons require doing so.

For the above reasons the “Basel and EU” option has been retained by the Commission services as the <u>only</u> possible working method in developing the new capital requirements framework.

4.3. The chosen approach: a EU legislative approach applicable to all EU credit institutions and investment firms parallel to the Basel process with specific departures where needed

4.3.1. Parallelism with Basel and specific departures

In view of the above considerations regarding the three main working options available to the EU, the Commission services have - with the support of industry and the competent authorities (finance ministers and supervisors) in the Member States - adopted the working principle that the EU capital adequacy framework should be revised in a manner that is

consistent with the new Basel II Accord, but appropriately differentiated where necessary to take account of specificities of the EU context.

In addition to the prudential implications, failure to reflect the new Basel II Accord in the legislative framework within the EU would have the potential to undermine the competitive position of EU financial institutions in the global market place, with significant implications for EU economy and society.

At the same time, there are a number of highly significant specificities of the European context which had to be fully taken into account and reflected in the design of the new framework. Among those, the most evident ones are the need to adopt a legislative approach and to apply the new capital adequacy rules across all types of EU financial institutions.

4.3.2. A legislative approach at the EU level

The Basel Committee does not possess any formal supranational supervisory authority, and its conclusions do not, and were never intended to, have legal force. Rather, it formulates broad prudential standards and guidelines and recommends statements of best practice in the expectation that individual authorities will take steps to implement them through detailed arrangements - statutory or otherwise - which are best suited to their own national systems.

An ordered and effective functioning of the EU internal market for financial services requires however that, from a prudential standards point of view, there are no impediments to the freedom of establishment of banks and investment firms in other Member States, and to the provision of financial services on a cross-border basis. This has been achieved (see sections 1.1 and 1.2) by means of a minimum harmonization of prudential standards at EU level obtained by means of directives (integrated in the CBD and the CAD) which allow the necessary flexibility at country level for adaptation to the specificities of the various national financial sectors.

This situation has implied the need to amend the existing CBD and CAD in order to reflect the new rules on capital adequacy. Alternative solutions would not have been compatible with an ordered and effective functioning of the EU internal market for financial services, and with the chosen working principle of parallelism with Basel with specific departures to reflect EU-interests.

4.3.3. An application to all credit institutions and investment firms

The application of the same prudential standards to all entities engaging in financial activities allows an effective functioning of the internal market as it creates a level playing field among different types of competing financial institutions.

Credit institutions and investment firms compete on the same markets when they provide investment services to consumers and engage in trading activities. For this reason, both types of institutions are subject to the same prudential requirements related to investment services, and in particular to the same requirements for market risk as specified in Directive 93/6/EC.

In order to maintain a proper and effective functioning of the EU internal market, the Commission proposal maintains this basic principle, except where appropriate differentiation in treatment is needed due to the specific differences that exist between the various types of institutions (see section 5.3)

5. MAIN POLICY TOOLS TO REACH THE OBJECTIVES

The purpose of this section is to present in appropriate detail the general policy tools which have been chosen in order to achieve the policy objective presented above (see section 3).

Given the vast complexity and the deep technical level of the solutions, it is here impracticable to go into the full detail of all the technical choices which have been discussed and refined with the contribution of competent supervisory authorities during more than five years of work.

It is instead possible to provide a broad outline of the retained solutions in view of the policy objectives presented earlier, and to stress the specific areas in which the Commission supports the outcome of the Basel discussion or has instead decided, after consultation with the Member States, to develop alternative solutions tailored to the EU specificities.

5.1. Achieving objective 1 (state of the art of prudential standards)

In very general terms and in view of the first objective, the Commission services are supportive of the overall design of the proposed new Basel II Accord, and in particular of the fact that it is conceived to be suitable to financial institutions of all sizes and levels of complexity by means of the offer it provides of a entire range of methods for the calculation of capital requirements of different levels of precision and complexity. This, in the Commission services view, represents a design which makes the new Basel II Accord a highly suitable basis for the new capital adequacy framework in the EU.

The calibration of the new Basel II Accord is the second key aspect of the support that the Commission services have for the new Basel II Accord. In particular, Commission services strongly support the objective of the Basel Committee to calibrate the new regime so that minimum capital requirements for 'Standardised' Approach banks remain on average, after taking into account the new operational risk charge, the same as under the 1988 Accord. As proposed by the Basel Committee, in terms of capital requirements there should be appropriate incentives for institutions moving to the more advanced approaches.

5.1.1. Achieving sub-objective 1: enhance risk sensitivity in capital requirements introducing the SA and IRB approaches

Given the diversity of institutions to which the framework will apply and the desirability of providing appropriate incentives for institutions to improve their risk measurement and management, two possible strategies have been considered, in parallel with the Basel process, to ensure that the economic risk of financial transactions is better captured by capital charges. These are an approach based on institutions' internal credit assessment systems and a revision of the standardised credit risk weighting scheme.

<u>The revised 'Standardised' Approach</u>

The revised 'Standardised' Approach is modelled quite closely on the existing credit risk framework, with risk weights determined by the allocation of assets and off-balance sheet items to a limited number of risk buckets. The risk sensitivity of this approach has however been enhanced by an increase in the number of exposure classes and risk buckets, and the use of credit rating agencies' ratings to assign risk weights where these are available ('external ratings').

A new risk weight is proposed for non-mortgage retail items. This will be 75% as compared with 100% currently. Similarly it is proposed that the risk weight for residential mortgage loans be reduced from 50% to 35%. The Commission services consider that these risk weights represent the appropriate ones for lending of this kind.

It is proposed to introduce a 150% risk weight for assets which are 90 days past due (100% for residential mortgage loans 90 days past due).

The approach represents a highly appropriate approach for those institutions in the EU which do not seek approval for the use of the more sophisticated internal ratings based approach (see below). On the one hand, the proposals do not represent a significant increase in levels of complexity as compared with the current framework. On the other, they introduce a degree of risk sensitivity which represents a welcome improvement as compared with the existing rules.

<u>The IRB approach</u>

The proposed Internal Ratings Based (IRB) framework represents an appropriate balance between soundness and prudence on the one hand and a level of complexity which ensures applicability to a wide range of EU institutions on the other. It represents a significant development in the calculation of credit risk capital requirements. Subject to a key framework of requirements ensuring the soundness of estimates, institutions are permitted to provide their own estimates of the risk parameters inherent in their different credit risk exposures.

A key component of the IRB framework is the availability of a 'Foundation' Approach (FIRB). This allows institutions to make use of their own estimates of probability of default, while using regulatorily prescribed values for other risk components.[7] The Commission services consider that this 'middle' approach will be attractive to and suitable for a large number of institutions within the EU.

Regarding the IRB rules for retail exposures, it is proposed to have only one IRB modality: the 'Advanced' Approach. Given the significantly greater levels of data which are available to institutions for the retail portfolio as compared with other exposure classes, the Commission services consider that this represents an appropriate approach which should be achievable by institutions which are able to comply with the requirements of the 'Foundation' Approach for other exposure classes.

The proposal contains specific EU provisions providing for the use by institutions of pooled data in the estimation of risk parameter values. This is subject to requirements as to the comparability and consistency of the rating systems and criteria used by other institutions in the pool. This will allow many smaller institutions to apply a more risk sensitive approach to calculating regulatory capital requirements where the size of the institution's own portfolios would in themselves provide insufficient data to comply with the minimum requirements for the estimation of risk parameters. The Commission services consider these provisions very important in the EU context.

The proposed 'roll-out' rules provide flexibility for institutions to move different business lines and exposure classes during a reasonable timeframe to the 'Foundation' or the 'Advanced' IRB Approach.

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[7] Institutions using the 'Advanced' Approach (AIRB) will need to provide their own values for all risk components.

The proposed new framework also allows partial use for non-material exposure classes and business lines, i.e. capital requirements for these exposures can be calculated permanently according to the rules of the revised 'Standardised' Approach even if an institution uses the IRB Approach for calculating minimum capital requirements for other exposure classes.

Furthermore, and significantly, the proposed EU framework recognises specifically that for small institutions with a limited number of sovereigns or institutions as counterparties, the requirement to develop a rating system for this kind of counterparty is potentially very burdensome. Therefore a permanent partial use for these exposure classes is proposed even in cases where institutions exposures to such counterparts are material.

To facilitate the commencement of the new IRB framework it is proposed, in line with the Basel rules, to include transitional provisions which will allow for a limited period the relaxation of a number of proposed requirements that institutions will need to comply with to use the IRB Approach. Especially important in this context is the initial proposed relaxation in the data requirements for the estimation of probability of default from five years data to two years (increasing by one year during each of the first three years of the new regime).

All of these provisions in the new rules will encourage institutions to apply for greater risk sensitivity in their business.

5.1.2. Achieving Sub-objective 2: reduction in capital arbitrage and introduction of a new approach on securitisation

The introduction of significantly enhanced risk-sensitivity as described in the previous paragraphs together with the closer alignment of the methodologies for calculating capital requirements with the methodologies of institutions for the measurement of their risks and the allocation of economic capital means that both the incentives and opportunities for capital arbitrage are significantly reduced.

In particular, for the first time a harmonised set of rules for capital requirements in relation to institutions' securitisation activities and investments has been introduced. This framework is designed to incorporate high-levels of risk-sensitivity. This will provide a very significantly improved capital requirements framework for such transactions – allowing institutions to take advantage of the funding, balance-sheet management and other advantages that such transactions can deliver. It will also result in a reduction in the extent to which securitisation might have been perceived as a tool for capital arbitrage purposes.

5.1.3. Achieving Sub-Objective 3: significantly enhanced recognition of credit risk mitigation

There is general agreement among supervisors that there is at present an insufficient recognition of sound risk management practices in the area of credit risk mitigation. The new framework seeks to identify the issues which are common to mitigation techniques and design an approach that would treat common underlying risks or economic effects in a consistent manner. While individual products or techniques might require some further specific tailoring, an advantage of this strategy is its perceived ability to adapt to continued innovation in this field.

Within a framework of prudential soundness, institutions stand to gain from the significant advances in the recognition of techniques of credit risk mitigation which are incorporated into

the proposed new capital adequacy framework. These include the recognition of a significantly wider range of collateral and guarantee / credit derivative providers than is the case under the existing regime. Under the IRB Approach, it is proposed also to give a prudentially appropriate level of recognition to financial receivables and physical collateral.

Alternative methodologies are made available so that institutions have the opportunity to choose methods of different levels of complexity. For example, in relation to the recognition of the risk-reducing effects of financial collateral, institutions may choose the Simple Method – which is based on an easy-to-use 'risk weight substitution' approach; or they may opt for the Comprehensive Method – which involves the application of volatility adjustments to the value of the collateral received. Similarly, in the calculation of volatility adjustments more and less complex approaches are made available – a straightforward 'Supervisory' approach where the amounts of the benchmark volatility adjustments are set out in a table in the draft proposed legislation; and a more risk-sensitive 'Own Estimates' approach.

These methodologies and approaches will greatly assist in achieving the sub-objective of enhanced recognition of credit risk mitigation.

5.1.4. Achieving Sub-objective 4: introduction of a requirement on Operational Risk

Three different methodologies will be available for use by institutions in calculating their operational risk capital charge.

A simple approach based on a single aggregate income indicator will be the Basic Indicator Approach (BIA). This approach will provide a capital buffer against operational risk, without requiring institutions to develop sophisticated and costly information systems about their operational risk exposure. Institutions using the BIA will nevertheless be required to comply with a set of basic risk management standards applicable to every institution.

A more precise approach based on business lines will be the Standardised Approach (STA). This approach aims to be more risk-sensitive, as the capital requirement for operational risk will be differentiated to reflect the relative riskiness of different business lines. The use of the STA will be conditional upon compliance with more developed risk management standards. In particular, institutions will be able to map their activities into different business lines, and will have a process to identify their exposure to operational risk. This approach is likely to be attractive to a large number of smaller / less complex institutions.

More sophisticated methodologies will be available under the Advanced Measurement Approach (AMA). Under this type of approach, institutions will have to be able to generate their own measure of operational risk, subject to more demanding risk management standards. AMA is expected to be gradually adopted mainly by the large internationally active institutions; but could also prove well suited for smaller specialised institutions which have developed advanced risk monitoring systems for their main activities.

An Alternative Standardised Approach will be available to institutions that are predominantly active in traditional banking activities (retail and commercial banking), and which can demonstrate a double counting between the operational risk charge and the capital requirement for credit risk. This variant of the Standardised Approach was developed in the light of the impact analysis referred to as QIS3 (see section 6.1.1).

Further impact analysis (see section 6.1.4) on investment firms has also identified, under the STA, possible double counting between the Trading and Sales business line and the capital charge for market risk. A transitional provision is proposed to address this potential double counting. This will allow, for firms where Trading and Sales is a large part of their business, a reduction in the charge applied to that business line to a level that eliminates the double counting. This transitional provision will continue until such time as the detail of the STA can be reviewed based on real life experience of the operation of this framework.

5.1.5. Achieving Sub-objective 5: reinforcement of risk assessment and management

Capital requirements are not a substitute for sound risk assessment and management. Every credit institution and investment firm has to have full awareness and control over its risks including, but not limited to, those treated under the minimum capital requirements.

To support smooth operating conditions at credit institutions and investment firms, the existing obligations on organisation have been expanded and enhanced to ensure that robust governance arrangements are implemented, effective processes to manage and report risks are operated, and adequate internal controls are in place. The board of directors of credit institutions and investment firms will have to ensure that duties are effectively segregated in the organisation and conflicts of interest are the prevented. It will also be required to approve and review the strategies and policies followed by the credit institution or investment firm to take up, manage, monitor and mitigate risks, including those related to the macroeconomic environment in which the institution operates in relation to the status of the business cycle. Further technical provisions will be laid down in relation to the major categories of risk credit institutions and investment firms are typically exposed to.

In order to maximise effectiveness of these requisites, they will apply to credit institutions and investment firms individually, and effective interconnections will have to exist within groups. However, given the diversity of the institutions covered by provisions, these requirements will have to be met on a proportionate basis.

This organisational infrastructure will permit institutions to maintain an ongoing balance between the risks they are exposed to and the capital they hold. This balance, and the strategies and processes implemented to continue it, will constitute a key element of the constant dialogue which has to exist between every institution and its supervisor concerning compliance with requirements on organisation and capitalisation.

5.1.6. Achieving Sub-objective 6: supervisors to review and evaluate institutions

To meet this sub-objective, competent authorities will be required to review the compliance by the credit institutions and investment firms with the various legal obligations in terms of organisation and risk control, and to evaluate the risks actually taken by the institutions. This assessment of the situation will have to be used by supervisors to determine whether weaknesses exist in the internal controls and capital held to meet risks.

Supervisors will be provided with a minimum harmonised range of robust legal powers to require institutions to address the inadequacies identified. This range will include the possibility to oblige credit institutions and investment firms to hold own funds in excess of the minimum requirements, to apply a specific provisioning policy, to reinforce the arrangements and strategies concerning the take up, management, monitoring and mitigation of risks, and to restrict or limit the business, operations or network of the supervised institutions.

In line with the principle according to which capital requirements are not a substitute for sound risk assessment and management, increased capital requirements will be just one of the alternative means available to rectify weaknesses or inadequacies of supervised institutions, to be exploited only if alternative measures concerning organisation cannot produce positive results in an appropriate timeframe.

5.1.7. Achieving Sub-objective 7: establishment of increased coordination among national supervisors

The new capital framework introduces approaches which firms will want to apply, and which can be applied most effectively, right across a financial group. In addition, the degree of cross-border business in the EU is increasing, and there is a trend towards centralisation of risk management within cross-border groups. This last trend will only be encouraged by the new directive.

All of these items lead to a need for improved coordination and cooperation amongst national supervisory authorities in the EU. Therefore the existing role of the consolidating supervisor, which is well established in the banking sector, has been developed further. Every cross-border group will have a consolidating supervisor, as at present. Certain additional tasks will be allocated to this supervisor, on a EU-wide basis. And relevant supervisors will need to work together to consider, and decide on, applications from cross-border groups for approval of sophisticated models and methodologies under the IRB and AMA approaches mentioned earlier.

5.1.8. Achieving Sub-objective 8: introduction of disclosure to markets

The disclosure of information by financial institutions to market participants contributes to greater financial soundness and stability while at the same time maintaining a level competitive playing field and respecting the sensitivity of certain information.

While the proposed new Basel II Accord will require a minimum semi-annual disclosure frequency for banks other than 'small banks with stable risk profiles', the Commission services propose to require disclosure on a minimum annual basis for the generality of institutions - while requiring them to assess whether more frequent disclosure is necessary in light of specific criteria. This, in the view of the Commission services, appropriately reflects the specific features of the EU context and is conceptually coherent with the approach of the Basel Committee.

5.1.9. Achieving Sub-objective 9: introduction of flexibility in the regulatory framework

The capital adequacy framework needs to keep pace with market developments, financial innovation, and progress in the techniques for the measurement and management of risks. The calibration of capital requirements may also need some revision to reflect developments in the actual exposure to risks.

The necessary degree of flexibility is brought by making a distinction between core stable elements of principle (in the articles of the directive) and technical rules (in the annexes to the directive) that will need adaptations in the short to medium run.

Whereas any future change to the core principles in the articles will require a co-decision procedure, the updates and adaptations to the technical rules will be subject to a comitology

procedure. This will be supported by the new committee architecture in banking (see section 7.2).

5.2. Achieving objective 2 (providing a proportionate capital treatment)

Key to EU interests is the need to have MCR which are usefully applicable in a EU economic context in which SME-financing plays a crucial role.

The Commission services believe that the Basel framework provides a prudentially sound treatment of SME lending which is nevertheless suitable to the situation of such borrowers.

Under the 'Standardised' Approach, as mentioned previously, a 75% risk weight for retail loans is being introduced. Loans to small businesses may be included in this category, subject to an aggregate exposure limit per borrower of €1 million. For unrated borrowers not falling within the retail asset class, the risk weight remains the same as under the current regime – i.e. 100%.

In relation to the IRB Approach, exposures to SMEs falling within the corporate asset class will receive a reduction in capital requirements as compared with loans to larger corporates based on a firm size-related adjustment to the risk weights. This incremental discount factor will start when borrowers have total annual sales of less than €50 million and will increase in inverse proportion to the size of the firm. The largest discount - 20% - will be available for lending to borrowers with annual sales of €5 million or less. And the average discount will be approximately 10%.

Furthermore, SME loans below an exposure size of €1 million can be treated in the retail portfolio. The capital requirement in the retail portfolio is generally lower than in the corporate portfolio because empirical evidence suggests that for any given combination of risk parameters the contribution to portfolio credit risk for retail and small SME exposures is lower than for other exposures.

Finally, loans to corporates situated in the EU with a turnover as well as total assets for the consolidated group below €500 million can be excluded from the explicit maturity adjustment (to be replaced by an implicit maturity assumption of 2.5 years) under the IRB 'Advanced' Approach where the competent authorities opt for such an approach for all institutions authorised by them.

5.3. Achieving objective 3 (appropriate treatment of investment firms)

With specific regard to investment firms the main issues at stake are: the impact of a new capital charge to cover operational risk, the new rules on consolidation, the new rules concerning the trading book

5.3.1. An appropriate capital charge for operational risk

Investment services are subject to harmonised regulation based on the Investment Services Directive (ISD)[8] and the CAD. Both credit institutions and investment firms have to comply with rules covering not only capital requirements but also conduct of business, segregation of clients' assets, administrative and accounting procedures, internal controls, and so on.

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[8] Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field.

The Commission services consider that in respect of some specific investment firms / investment services business lines a lower calibration of the operational risk charge - as compared with the charges currently being proposed in the new Basel II Accord – are justified in the EU legislation. This is because the calibration in Basel of these business lines was based on data for credit institutions, and not for investment firms.

In reaching this view the Commission services have had regard to an informal study carried out in 2001 in relation to the likely impact of the new operational risk charges on investment firms and to the fact that within the EU such services are covered by the customer protection requirements and risk management standards of the Investment Services Directive (whether they are carried out by credit institutions or investment firms).

In order to benefit from the alternative operational risk charge, investment firms need to comply with a number of specific risk management standards and operational arrangements for investment services, as these can play a role in reducing the frequency and severity of operational risk losses.

The proposal consists of the following:

- a separate treatment for investment firms with a 'limited licence', which are perceived to be lower risk firms. This will apply to firms that do not carry out trading on their own account or underwriting of securities issues on a firm commitment basis. The treatment will allow these firms to continue to base their capital requirements on the Expenditure Based Requirement (EBR), as at present;

- a treatment for investment firms which take trading positions only to fulfil client orders or because the rules of exchanges or clearing houses require the position to be in their names. These firms will face market and credit risk only when problems arise with these transactions. Therefore the treatment will require firms to hold capital equal to the EBR plus any market and credit risk charges they face.

5.3.2. A more sound scope of consolidation for investment firms groups

It is proposed to amend the existing alternative to consolidated capital requirements for investment firms groups. It is proposed that this alternative be available only to groups that meet a number of stringent specified conditions. It will be required, inter alia, that (i) no credit institution is included in the group; (ii) the group engages in a limited range of activities which does not include own account dealing or underwriting of issues with firm commitment; and (iii) the group is adequately capitalised. In such very limited cases the Commission services have considered that the objectives of prudential supervision on a consolidated basis can be achieved without imposing consolidation.

5.3.3. A planned future solution to trading book issues

Trading business has an important role to play in ensuring the efficiency of financial markets and the effective allocation of resources within the EU economy. Appropriate capital charges for trading book business contribute to financial stability while not discouraging firms from playing this important economic role.

The new Basel II Accord will not include a fundamental review of all trading issues, or of all issues concerning the management of market risk. But important advances have been made in a number of areas.

A number of changes will be made to the specific risk charges for different types of financial instruments, to make these charges more risk sensitive. A specific treatment will also be introduced for trading positions in collective investment undertakings. And changes will be made to reflect the development of credit derivatives as a separate asset class.

As part of a 'next phase' of work the Basel Committee will undertake further consideration of the treatment of counterparty risk for trading transactions. The Commission will participate in this important work reflecting the dynamic nature of the new capital requirements framework.

6. EXPECTED IMPACTS FROM THE IDENTIFIED SOLUTIONS

6.1. Impact studies

In section 5, a number of solutions to the major issues presented by the existing situation have been presented. This section addresses in short the main thrust of the impacts of the solutions described in section 5 from an economic and social point of view.[9]

6.1.1. The impact on capital requirements

Table 1 shows the changes in capital requirements deriving from the new capital adequacy framework.

The new rules will in general reduce capital requirements for EU credit institutions by around 7% compared to present levels.

The outcomes for the different approaches are generally in line with objectives – in particular that of combining capital neutrality with appropriate incentives for institutions to move towards more sophisticated approaches. This is an important achievement of the framework to which the Commission attached significant importance.

Smaller domestic 'group 2' banks[10] adopting the SA approach will face slightly reduced capital charges (-1.07%).

Larger internationally active 'group 1' banks adopting the IRB approach will face substantially unchanged capital charges (1.68% if FIRB and -3.85% if AIRB).

EU 'group 2' banks adopting the FIRB approach will face substantially lower capital requirements than under the current framework (-25.29% if FIRB and -23.12% if AIRB).

The results show an incentive to adopt the AIRB approach for large 'group 1' banks, with an overall decrease of around 5-6% compared to the FIRB approach.[11]

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9 The major impact studies that have been performed are listed in Annex I and are available on the Commission's website at: http://europa.eu.int/comm/internal_market/regcapital/index_en.htm.

10 Banks have been divided into two groups. 'Group 1' (G1) banks are larger internationally active banks, with Tier 1 capital in excess of 3 billion EUR. 'Group 2' (G2) banks are smaller (and generally less-complex) not internationally active banks.

Table 1: Average change in minimum capital requirements - Values In %[12]

	SA	FIRB	AIRB
1 - EU G1 Institutions	8.54 5.65	1.68 -3.44	-3.85 -5.07
2 - EU G2 Institutions	-1.07 0.82	-25.29 -20.93	-23.12 -27.12
4 - All EU Institutions	-6.70		
5 – All EU Institutions likely to adopt approach in question	1.92	-8.86	-10.06

These impact figures are the result a calibration process of the new Accord made of three main steps. In fact, after the publication with QIS3 of the impact of a set of rules published in the Third Consultation paper and referred to as 'CP3' (see section 8.2.5) which constitutes the backbone of the final proposals, a specific amendment on the calculation of expected losses (EL) and unexpected losses (UL) was introduced by the Basel Committee. This technical amendment modified the impact of the proposal (as indicated further in section 6.1.3) in a way that was no longer consistent with the main calibration objectives of the new framework. For this reason, a recalibration by means of a 1.06 multiplier of IRB formulas has been necessary, leading to the final impact figures shown above.

6.1.2. QIS3

The Commission services assisted the Basel Committee in its Third Quantitative Impact Study (QIS3) exercise for the production of impacts for the European Union (EU) area, and for an enlarged area comprising banks from the EU as well as from six additional countries (EU+6) including certain new Member States or countries belonging to the European Economic Area.[13] The results of the QIS3 were published by the Commission on 01.07.2003, contemporaneously to the publication of CP3.

[11] It is important to recall, however, that differences in results between FIRB and AIRB are partly driven by the different samples of banks providing the data and that they should be considered with caution.

[12] Figures in bold represent weighted averages. Figures in italics represent simple averages. Lines 1 and 2 only reflect the differences in national banking system sizes. Lines 4 and 5 reflect both the differences in sizes in national banking systems and a best estimate agreed with national supervisors of which approaches institutions will actually choose in each country at the date of implementation. For more detailed background on the methodology adopted in producing the weighted average results, a Methodological Annex is available on the Commission's website at: http://europa.eu.int/comm/internal_market/en/finances/capitaladequacy/index.htm.

[13] The QIS3 exercise is based on consolidated data. As most of the new Member States banking system is consolidated in the EU results, they can be considered as generally relevant not only for the EU-15 but also for the EU-25 area. The EU+6 results include the minor part of the banking system not already consolidated in the EU figures and they should be considered as a confirmation of the EU results.

The following key conclusions can be drawn from Table 2, which illustrates the expected impacts on European banks of CP3 rules as of 01.07.2003.

CP3 rules did in general reduce capital requirements for EU banks by around 5% compared to present levels, which is around 2% less than in the final proposal.

While results are in general fully comparable to the impact results of the final proposals, QIS3 indicated also that the change in capital charges for EU+6 ‘group 2’ banks in the SA was not particularly higher than in the EU.[14] A moderate increase in capital charges could however be registered in new Member States.

Table 2: Average change in minimum capital requirements according to CP3 rules – Values in %

	SA	FIRB	AIRB
1 - EU G1 Institutions	8.54 5.65	1.99 -3.69	-3.67 -5.74
2 - EU G2 Institutions	-1.07 0.82	-23.75 -20.18	-17.00 -22.45
3 - EU+6 G2 Institutions	3.09		
4 - All EU Institutions	-5.31		
5 – All EU Institutions likely to adopt approach in question	1.92	-6.86	-8.74

Importantly (see Table 3), QIS3 also showed that the main source of reduction in capital requirements is the retail portfolio, which is mostly composed of loans to Small and Medium Enterprises (SMEs) below EUR 1 million and residential mortgage loans. This reduction reflects the new risk weight functions and compares favourably with the present rules which carry retail exposure charges that are felt to be higher than their actual risk.

14 EU+6 impacts are presented only limited to ‘group 2’ banks for the SA. The results for the EU+6 area did not show in fact any significant differences from EU results for ‘group 1’ banks in all approaches and for ‘group 2’ banks in the FIRB and AIRB approaches.

Table 3: Contributions to overall likely change in minimum capital requirements according to CP3 rules – Values in %

4 - All EU Institutions			
Sovereign	1.00	Trading Book	0.12
Bank	1.20	Specialised Lending	0.74
Retail (incl. SMEs)	-10.99	Equity	1.06
Corporate non SMEs	-3.02	Receivables	-0.02
Corporate SMEs	-3.75	Investments Related Entities	0.94
Operational Risk	8.83	General Provisions	-1.75
Securitisation	0.24		

QIS3 also showed that other important sources of decrease in the capital requirements are the exposures to corporate non-SME customers and to corporate-SME customers. This means that capital requirements for loans to large enterprises and SMEs will be generally no higher - and in many cases lower - than at present.

QIS3 finally showed that Operational risk was the main source of increase in capital requirements, even though the capital charge would tend to be lower than the initially targeted figure of 12%.

6.1.3. The Madrid EL-UL decision

On 10-11 October 2003, the members of the Basel Committee met in Madrid to decide on responses to public comments received on the new Basel II Accord. With respect to the internal ratings-based IRB treatment of credit losses, the existing proposals called for banks to hold enough capital to absorb expected and unexpected credit losses (EL and UL) with a particular treatment for provisions. However, in the light of the public comments received on CP3, the Committee decided to revisit the issue and to adopt an approach based on unexpected losses only (UL).

Under this modified approach, the measurement of risk-weighted assets (that is, the IRB capital requirement) is based solely on the unexpected loss portion of the IRB calculations. Additionally, banks compare the IRB measurement of expected losses with the total amount of provisions that they have made, including both general and specific provisions. For any individual bank, this comparison produces a "shortfall" if the expected loss amount exceeds its total amount of provisions or an "excess" if the total provisions exceed the expected loss amount. Finally, shortfalls have to be deducted from capital, and excesses have to be added to capital with a limit set at 0.60% of Risk Weighted Assets.

As shown in Table 4, after the EL-UL Madrid decision the new rules would have in general reduced capital requirements for EU banks by around 9% compared to present levels. It meant a further reduction of around 4% compared to CP3.

Table 4: Average change in minimum capital requirements after the EL-UL Madrid Decision - Values In %

	SA	FIRB	AIRB
1 - EU G1 Institutions	8.54 5.65	-2.28 -7.07	-7.49 -8.6)
2 - EU G2 Institutions	-1.07 0.82	-28.36 --24.00	-26.50 -30.11
4 - All EU Institutions	-9.43		
5 – All EU Institutions likely to adopt approach in question	1.92	-12.39	-13.55

Larger internationally active 'group 1' banks adopting the IRB approach would have faced moderately reduced and not any more substantially unchanged capital charges (-2.28% if FIRB and -7.49% if AIRB).

EU 'group 2' banks adopting the AIRB approach faced lower capital requirements than under CP3. The further reduction of requirements for these institutions was around 8-10%.

EU 'group 2' banks adopting the FIRB approach faced substantially lower capital requirements than under the current Accord, and around 4-5% less than under CP3.

6.1.4. The 1.06 multiplier recalibration

On the basis of the impact results stemming from the EL-UL Madrid Decision, and in particular of the consideration that the calibration of the new framework would no longer meet its calibration objectives, a recalibration by means of a simple multiplier of 1.06 to be inserted in IRB formulas was considered in order to move the impact back broadly to CP3 levels. This recalibration has led to the final impact figures commented above in section 6.1.1.

6.1.5. PricewaterhouseCoopers' Report

The European Council at its meeting in Barcelona of 15 and 16 March 2002 requested the Commission 'to present a report on the consequences of the Basel deliberations for all sectors of the European economy with particular attention to SMEs'. The definitive version of the study was delivered by PricewaterhouseCoopers (PWC), the selected contractor, on 13 April 2004 in line with the timetable set in the contract.

In the context of a general assessment that, on balance, Basel II will be positive for the EU economy and prudential structures, the key conclusions of the study are as follows:

– EU banks' capital requirements will decrease up to ± 5% (€ 80-100 billion) and translate into an annual increase in profits of up to ±€ 10-12 billion;

- Although Basel II is expected to only have a limited effect on pricing of most bank lending, there will be extensive behavioural effects: banks will evaluate risk better and take more informed lending decisions;

- The more risk-sensitive behaviour of banks that Basel II will entail is likely to produce in the long run to a more efficient allocation of capital in the economy;

- There will be no negative impact on the availability and cost of finance for SME's in most EU Member States. Fears of negative effects of Basel II on SMEs tend to derive from lack of adequate information, and not from the contents of the new capital adequacy regime;

- There isn't any automatic disadvantage for smaller banks and any indication that Basel II will force M&A's and consolidation in the banking sector;

- The decision to cover all banks in the directive will not put EU firms at a competitive disadvantage, nor is the US decision to apply on advanced approaches to some 20 big banks a significant competitive factor;

- It is important to monitor that the various areas of national discretion embedded in the new framework do not become a source of competitive disadvantages in the EU single market for financial services;

- Implementation costs for EU-banks are not solely driven by Basel and many of these investments would have happened anyway, although over a longer period;

- Basel II procyclicality effects may be less — and less damaging — than the procyclicality of the present Basel I Accord.

PWC notes two areas of concern that merit the Commission's attention:

- the treatment of investment firms and in particular the trading book and operational risk requirements. PWC concludes that the Commission's proposals for small firms are adequate, but that more work needs to be done on the large firms. After the delivery of the study the Commission services have worked closely with the industry and have resolved most of the trading book problems and proposed modifications to the operational risk rules (see sections 5.3.1 and 5.3.3).;

- venture capital investments by banks need further consideration. The Commission services have worked closely together with the venture capital industry and proposed appropriate amendments in the rules to take account of industry concerns as far as they can be justified. In particular, analysis provided by the venture capital industry showed that the originally proposed capital requirements are correct for single equity investments, but that for diversified portfolios risk decreases significantly and therefore the capital requirements should be lower. As a consequence, the Commission services have made available preferential treatments for venture capital financing, such as a reduction of the LGDs from 90% to 65% in the IRB Approach. Venture capital industry has shown broad agreement and satisfaction with the proposed preferential treatments.

The study finally looks at the very costly consequences from an economic and social point of view of banking crises. As the causes of banking distress and bank failures are numerous, no regulatory regime, irrespective of how well founded, is able to eliminate completely the

possibility of such events. The new framework, however, should nevertheless help reduce the frequency and the costs of such incidents.

PWC's study and conclusions confirm the Commission's own consistent policy messages and reflect the enormous efforts that have been made to present sensible and responsible capital adequacy rules.

6.1.6. Investment Firms QIS

Given the lack of investment firm data included in the Basel exercises, and the intention to apply the capital framework to both credit institutions and investment firms in the EU, the Commission has carried out a number of separate impact studies on investment firms.

During early 2003 the Commission coordinated a data-sharing exercise amongst national supervisors. This is discussed in the Explanatory Document to the Commission's CP3, published in July 2003.[15] The main output from this exercise was the finding that for the large majority of 'limited licence' firms, the Expenditure Based Requirement ('EBR') remained the most important element of the MCR, so it was appropriate to move forward with a treatment based on EBR.

Further analysis of this data later in 2003 highlighted that the policy conclusion reached with regard to 'limited licence' firms was correct,[16] but that further work was needed in relation to other investment firms.[17] A further impact study was carried out early in 2004, specifically to look at the expected impact of the new capital framework on other investment firms. This impact study led to two separate conclusions:

- that for firms whose business includes a significant proportion of trading and sales, there is the possibility of double counting between the capital requirements for operational risk and market risk, if the firm were to use the Standardised Approach for operational risk;[18]

- that the introduction of an explicit operational risk charge for investment firms carrying out limited activities would lead to substantial capital increases that are not justified by any change in the risk profile of the firms. A treatment based on EBR, but extended to reflect the fact that these firms can face market exposures, is considered to be appropriate.[19]

6.2. Special topics

6.2.1. Impact on smaller and less complex institutions

PWC's study reaches the conclusion that there is no automatic disadvantage for smaller banks and no indication that Basel II will force M&A's and consolidation in the banking sector.

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15 See paragraph 351 of http://europa.eu.int/comm/internal_market/regcapital/docs/cp3/200307-workingdoc/explanatory-doc_en.pdf

16 See the penultimate bullet point in section 5.3.1.

17 See paragraph 178 of http://europa.eu.int/comm/internal_market/regcapital/docs/cp3/200403-feedback/feedback-doc_en.pdf.

18 This conclusion applies to both investment firms and to credit institutions. It is the activity – trading and sales – that can produce the double counting, not the nature of the firm. See section 5.1.4.

19 See the last bullet point of section 5.3.1.

6.2.2. *Impact on investment firms and investment services*

The PWC's study concludes that the Commission's proposals for small firms are adequate, but that more work needs to be done for large firms. As set out in sections 5.3.1 and 6.1.6, the Commission has carried out further analysis of the likely impact of the capital framework on these larger firms, and has put forward policy proposals to ensure that the impact is not excessive.

6.2.3. *Impact on new Member States*

QIS3 has been conducted on the basis of credit institutions' consolidated financial situations. Given that a large part of the banking system of new Member States is mainly controlled by EU credit institutions and consolidated in their financial accounts, the QIS3 impact results cover also new Member States to a very considerable extent.

For sake of completion, a further analysis has been conducted in a selected number of new Member States on the independent part of the banking system. The results have proven to be comparable to the results already obtained for the EU (see the 'EU+6' QIS3 results in section 6.1.2).

6.2.4. *Impact on SMEs*

QIS3 results suggest that credit risk capital requirements will generally decrease in the EU. Clearly, the variation in capital requirements will differ between different parts of the SME population, based on the credit quality of individual borrowers, the average credit quality in an industry or a region and the level of collateralisation.

PWC's study indicates that the new capital regime should not have a negative impact on the availability and cost of finance for SMEs in most European countries. As credit risk capital requirements relating to SMEs are likely to decrease under the new framework, there should be no negative impact on the availability and cost of finance for SME's in most EU Member States. Fears of negative effects of Basel II on SMEs tend to derive from lack of adequate information, and not from the contents of the new capital adequacy regime;

6.2.5. *Impact on the macroeconomy*

The PWC's study concludes that the implementation of the new capital requirements framework is unlikely to have a major impact on the large macroeconomic aggregates such as GDP, employment, investment and prices at the European level. In particular, if the lower capital requirements will translate into a reduction of the cost of borrowing to corporates, then the new framework might give a modest benign supply-side stimulus to the EU economy, generating an investment-led expansion of around 0.07% of GDP.

6.2.6. *Impact on financial stability*

PWC's study indicates that although the new framework is expected to only have a limited effect on pricing of most bank lending, there will be extensive behavioural effects: banks will evaluate risk better and take more informed lending decisions.

In view of this, PWC's study observes that even if no regulatory regime is able to completely eliminate the possibility for banking crisis, the new framework should nevertheless help reduce the frequency of such incidents.

6.2.7. Procyclicality of the new framework

There is no general or simple answer to the question of cyclicality. A closer alignment of minimum capital requirements with actual risks while beneficial and desirable also means that minimum capital requirements are likely to increase in times of economic difficulty.

The Commission services consider that the draft new framework – and in particular its emphasis on improved risk management and measurement and its requirement for 'changed conditions' stress testing – strikes an appropriate balance in this regard.

The Commission services also agree with consultation respondents that this is an important issue which must be kept under continuing review. For this reason the directive will propose a clause to monitor its effects through the economic cycle. The Commission and the ECB will report regularly to the European Council and the European Parliament on this (and the Commission will propose any necessary changes).

7. HOW THE RESULTS AND IMPACTS OF THE PROPOSAL AFTER IMPLEMENTATION ARE MONITORED AND EVALUATED

The proposal is expected to follow normal implementation procedures, i.e. transposition in Member States within 18-24 months.

7.1. Harmonisation of provisions

Under the existing framework, rules concerning the role and action of supervisory authorities are relatively limited. Member States are required to have established authorities empowered to supervise credit institutions and investment firms. These authorities must confirm compliance by institutions with the minimum requirements prescribed by the legislation and take appropriate steps to ensure compliance in the event of a breach of those requirements by institutions.

The proposed new capital adequacy framework is more complex than the existing framework. Supervisory judgement and discretion will play a central role in its implementation and success. Not only is supervisory approval necessary for institutions wishing to adopt the more advanced approaches under Title II, but as described in section 5.1.6, the requirement that institutions are adequately capitalised in relation to their risk profile as a whole is a fundamental aspect of the framework.

This means in short that under the new regime there is scope for potential divergence in the application of the new framework in different jurisdictions.

For the Commission services, ensuring that the new framework is implemented consistently across the EU and does not give rise to inter-jurisdictional competitive distortions is a key aspect. One way in which this question is addressed is through appropriate harmonisation of the principles and requirements applying to supervisory authorities in carrying out their responsibilities under the new regime. In developing proposals in this regard, as described in section 5.1.6, the Commission services are seeking to strike the right balance between harmonised implementation on the one hand and the need for an appropriate scope for supervisory discretion and judgement on the other.

7.2. 'Lamfalussy' in banking

In addition to normal monitoring by Commission services, the application to the banking sector of the Lamfalussy committee structure[20] has led to the situation in which a further revision of the CBD and CAD will be supported by two Committes: the regulatory committee with comitology powers -European Banking Committee (EBC)- and an advisory committee of supervisors -the Committee of European Banking Supervisors (CEBS)

The EBC will be consulted by the Commission on policy issues, and will provide a formal opinion on draft implementing measures (e.g. amendments to the technical rules of the directive) proposed by the Commission. The CEBS will be asked to provide a technical advice on the draft implementing measures. Close coordination between the policy level (Commission/EBC) and the technical level (CEBS) has already been organised. In addition to its advisory role, the CEBS will also contribute to the consistent application of day-to-day supervisory practices in the EU.

8. STAKEHOLDER CONSULTATIONS

8.1. Stakeholders in a capital requirements directive

During the preparation of the draft directive the following stakeholders were identified:

- Credit institutions and Investment Firms: It is evident that credit institutions are the most directly concerned by amendments in the supervisory framework. They will be subject to a new set of rules that may require some entities to change their procedures or raise more capital. However, the system will also give a quality mark to EU financial institutions which will be a distinct advantage on the international market (see sections 3.1, 3.3, 5.1 and 5.3).

- Corporates and SMEs: Corporates and SMEs represent the very engine of the European economy. They play a crucial role in promoting the innovation, growth and employment which is essential to the economic success of the Union and to the welfare of its citizens. It has therefore been a central objective that the new capital adequacy framework does not result in disproportionate capital requirements in relation to financing of such entities (see sections 3.2 and 5.2).

- Banking supervisors: Member States' competent authorities will be deeply involved in the implementation of the new framework and will be responsible for its enforcement. They are interested to the overall structure of the regulation, its suitability for the EU financial institutions, the correspondence between the supervisory controls required under the new regime and the sufficiency of legal powers it grants, the planning of their infrastructure and human resources (see in particular section 5.1.6).

- Governments, Taxpayers and Consumers: Governments and taxpayers are interested in the reduction of the costs that financial institutions failures impose directly and indirectly on society: directly in the form of bail-out and work-out costs; indirectly in the form of less

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[20] For further information, see: http://europa.eu.int/comm/internal_market/en/finances/mobil/lamfalussy_en.htm

employment, credit, investment and re-allocation of resources. Consumers are sensitive to the protection of depositors and investors. (see in particular sections 1.1 and 6.2.6)

8.2. Public consultations

A large number of public consultations have taken place between 1999 and 2004 with all stakeholders. Each consultation was followed by a comprehensive feedback paper from the Commission's services. This section gives a brief description of the main characteristics of each consultation[21].

8.2.1. 'CP1' – 22.11.1999

The first consultations on a new capital adequacy framework for banks and investment firms were launched on 22 November 1999 by the European Commission's services. Financial services practitioners, market analysts, consumer groups, Member States and other interested parties were asked to comment by the end of March 2000 on a consultative paper prepared by the Commission's services. The paper identified a number of areas where the most significant issues were identified, notably credit risk (including credit risk mitigation techniques), so-called "other risks", supervisory review and market discipline. The consultation exercise complemented the consultation undertaken by the Basel Committee on Banking Supervision which was launched on 3 June 1999.

8.2.2. 'CP2' – 05.02.2001

On 5 February 2001 the European Commission's services launched a second round of consultations on a new capital adequacy framework for banks and investment firms. Financial service practitioners, market analysts, consumer groups, Member States and other interested parties were again invited to comment by the end of May 2001 on a consultative paper.

The consultation document was designed to be read in conjunction with a similar consultation on the new Basel Capital Accord launched by the Basel Committee on 16 January 2001, but concentrated on issues where particular EU concerns needed to be taken into account.

8.2.3. Structured Dialogue – 18.11.2002

The European Commission's services published on 18 November 2002 an advanced and detailed Working Document setting out their thinking at the time on a new capital requirements framework for banks and investment firms.

The Working Document, which was accompanied by a Cover Document designed to act as an explanation and guide, formed the basis of a period of enhanced dialogue (the 'Structured Dialogue') with representative bodies and trade associations from the financial services and other sectors. At the EU level, this dialogue was carried out directly by the Commission services. At the national level, it was co-ordinated by the relevant supervisory authorities.

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21 A complete list of the consultation documents can be found in Annex II. The consultation documents mentioned below are available on the Commission's website at: http://europa.eu.int/comm/internal_market/en/finances/capitaladequacy/index.htm

The consultation period ran from 18 November 2002 to 21 February 2003 and primarily involved representative bodies and trade associations from the financial services and other sectors. Over 100 written comments were received.

8.2.4. 'Real Estate and Covered Bonds' – 07.04.2003

On 7 April 2003, the Commission services published two specific pre-consultative working papers on the treatment of real estate lending and the treatment of covered bonds. The Commission services received 20 comments before the deadline of 30 April and based on these comment new proposals before the start of the third consultation process.

8.2.5. 'CP3' – 01.07.2003

On 1 July 2003 the European Commission's services published a third consultation paper (CP3) on a new capital requirements framework for banks and investment firms. The consultation exercise aimed to help ensure that the future revised EU Directive on capital requirements, due to come into force at the end of 2006 in parallel with the new international Basel II Accord, is of the highest quality. The consultation period ran until 22nd October 2003. Approximately 130 responses were received to the Commission services third consultation paper.

8.2.6. 'EL-UL' – 26.11.2003

On 26 November 2003, a consultation note on the revised proposals of the Basel Committee on Banking Supervision concerning the treatment of expected and unexpected losses in the proposed new capital requirements framework was published. The Commission sought comments from interested parties on the proposed new rules on the treatment of expected losses and the recognition of provisions by 31 December 2003.

8.2.7. 'CIUs' – 03.02.2004

On 03 February 2004, a working document was published setting out revised proposals for the treatment of investments in collective investment undertakings (CIU) in both the trading and banking books. The proposals were intended to bring the banking and trading book treatments closer together, and to address issues raised by respondents to CP3. Eleven responses were received before the deadline for this consultation which was set for 29 February.

8.2.8. 'CP3' - Feedback Document - 15.03.2004

Responses to CP3 have been significant and made an important contribution to the finalisation of the new capital requirements framework. A Feedback Document was published on 15 March 2004 to summarise a range of important issues in relation to which comments were made and to set out the Commission services' position on these issues having taken into account respondents' comments.

8.3. Comments received

It is not possible to provide in this document a detailed analysis of all the comments on the various specific issues of the proposals received during the many consultations described above. It is however useful , and it is the objective of this section, to briefly summarize the main tenor of the comments received throughout the consultation process on the most relevant topics.

8.3.1. On the objectives of the capital review project

Commentators have generally been very supportive over time of all the three major objectives of the project. The goal of enhanced risk-sensitivity leading to greater financial stability has been particularly supported. Respondents to consultations have greatly agreed that there is a need for new capital requirements to replace the existing rules.

There has also been strong support for the Commission's approach to the relationship between the proposed EU rules and the new international framework which is being completed by the Basel Committee, in particular for the Commission's central working principle that the EU capital framework should be revised in a manner that is consistent with the new international framework but differentiated where necessary to take account of EU specificities.

8.3.2. On the major policy issues

Less complex institutions

There has been broad and significant support for the general application of the proposed new rules in Europe – to all credit institutions and investment services providers whatever the precise legal nature and level of complexity of the institution in question. This reflects the perception that the proposed new framework – and in particular its incorporation of a number of approaches of different levels of sophistication – has been well designed for the purposes of broad application. Respondents have indicated that this approach supports and enhances the objectives of the single market level playing field. Moreover respondents have regarded it as strongly desirable that all institutions be included in the new framework so as to avoid the perception of 'second class' institutions that would be likely to result if some were excluded.

Flexibility of the new directive

There has been continued wide and strong support for the approach proposed to ensure that the new framework is responsive to market and supervisory innovation. This has been regarded as essential to maintain an optimally efficient and competitive EU financial services sector. Stakeholders have supported the approach where enduring principles and objectives are set out in the articles and provide the mandate for the more detailed and technical provisions contained in the annexes. Respondents have stated that the procedure for amending the annexes must ensure full and effective consultation with interested parties.

Investment firms

Concerns have been expressed by some from the investment firm sector about being subject to capital requirements which they perceived to be more appropriate for credit institutions and not suitable for the specific risk profile of investment firms. Significant modifications have been introduced to address these concerns within the constraints of prudential soundness. Some respondents have mentioned that it is very important that the EU process is capable of adopting developments in relation to trading book aspects important for investment firms, which may be agreed in Basel after agreement on the new Accord.

Complexity

Some respondents have commented on the perceived complexity of the proposed new rules. They asked for simplification and a reduced degree of prescription. On the whole, the Commission has increased the clarity and user-friendliness of the draft text. The proposed new framework itself does not represent an unduly complex framework. The design will be attractive to those institutions seeking simple rules to apply or wishing to progress gradually to more complex capital rules. So the proposed new framework contains a range of options and approaches of different degrees of sophistication. Institutions are able to choose their approach based on the degree of complexity with which they are comfortable. In relation to the more sophisticated approaches, for the first time institutions will be permitted to use their own estimates of risks to calculate their capital charges.

8.3.3. On detailed legal issues.

Since 1999 there have also been several consultations on detailed legal issues. The current proposal has been prepared taking account of comments from interested parties, in particular

the banking and investment firm industry. Many of the submissions were very detailed and provided very useful input to the work of the Commission services.

9. COMMISSION DRAFT PROPOSAL AND JUSTIFICATION

9.1. 'Re-casting' legislative technique

A simplified legislative methodology for the incorporation of the proposed amendments in the existing legislation has been identified. This methodology – the so-called 're-casting technique' (see Interinstitutional Agreement 2002/C 77/01) – enables substantive amendments to existing legislation to be proposed and approved without the introduction of a self-standing amending directive. Rather, the means of amendment is the introduction of the proposed amendments directly into the existing legislative text in a distinct presentational format.

These proposed amendments are subject to the same legislative co-decision procedure as would be adopted in the context of a self-standing amending directive. The key difference is one of reduced complexity of text – with the discussions being focused directly on the amendments as they are proposed to appear in the existing legislation and not on a separate amending directive. The re-casting technique is designed to make Community legislation more accessible and comprehensible.

The Commission considers that there are very major benefits in terms of presentation and clarity associated with the 're-cast' approach and proposes to adopt this approach for the introduction of the new capital requirements framework.

9.2. Outline of amended Directive 2000/12/EC

The existing solvency ratio requirements for credit risk have been replaced by two new methods available to credit institutions to calculate their credit risk requirements. In particular, the 'Standardised' Approach (Art. 47 – 53) is modelled quite closely on the existing framework, with risk weights determined by the allocation of assets and off-balance sheet items to a limited number of risk buckets. The risk sensitivity of this approach has been enhanced by an increase in the number of exposure classes and risk buckets The Internal Ratings Based (IRB) approach (Art 54 – 58), permits (subject to a key framework of requirements ensuring the soundness of estimates) instead credit institutions to use their own estimates of the risk parameters inherent in their different credit risk exposures. Within the IRB approach, the 'Foundation' Approach allows credit institutions to use their own estimates of probability of default, while using regulatory prescribed values for other risk components. Under the 'Advanced' Approach, credit institutions may use their own estimates for losses given default and their exposure at default. To facilitate movement to the new IRB framework it is proposed, in line with the Basel rules, to include transitional provisions which will allow for a limited period the relaxation of a number of requirements that credit institutions will need to comply with to use the IRB Approach.

Credit institutions will be required to have in place internal processes to measure and manage the risk they are exposed to and the amount of capital they deem adequate to support these risks. And Competent authorities will be required to review compliance by credit institutions with the various legal obligations in terms of organisation and risk control, and to evaluate the risks actually taken by credit institutions.

Credit institutions will be further required to disclose information to market participants in order to contribute to greater financial soundness and stability.

In order to allow the capital adequacy framework to keep pace with market developments, financial innovation, and progress in the techniques for the measurement and management of risks, a distinction is introduced between core and technical rules that will need adaptations in the short to medium term. Technical rules, mainly grouped into technical Annexes will be able to be modified by means of a rapid comitology procedure.

9.3. Outline of amended Directive 93/6/EEC

The CAD directive extends the new rules on capital requirements for credit risk and operational risk present in the CBD to investment firms.

The new provisions on the adequacy of internal processes and market disclosure are extended to investment firms as well. And as for credit institutions, competent authorities will be required to review compliance by the institutions with the various legal obligations in terms of organisation and risk control.

The distinction between core and technical rules that will need adaptations in the short to medium run is also being introduced for investment firms.

ANNEX I: IMPACT ANALYSIS DOCUMENTS PREPARED DURING THE PROJECT

See website: http://europa.eu.int/comm/internal_market/regcapital/index_en.htm and Annexes

Date	Document	Source	Language
	Review of the Capital Requirements for EU Investment Firms - 2004 Quantitative Impact Study: Main results	Annex	en
	Review of the Capital Requirements for EU Investment Firms - 2004 Quantitative Impact Study: Statistical Analysis Annex	Annex	en
08.04.2004	Study on financial and macroeconomic consequences of the draft proposed new capital requirements for banks and investment firms in the EU	Website	en
01.07.2003	Review of the Capital Requirements for Credit Institutions and Investment Firms - Third Quantitative Impact Study: EU Results	Website	en
01.07.2003	Review of the Capital Requirements for Credit Institutions and Investment Firms - Third Quantitative Impact Study: Methodological Annex	Website	en

ANNEX II: CONSULTATIVE DOCUMENTS PREPARED DURING THE PROJECT

See website: http://europa.eu.int/comm/internal_market/regcapital/index_en.htm

15.3.2004	REVIEW OF CAPITAL REQUIREMENTS FOR BANKS AND INVESTMENT FIRMS COMMISSION SERVICES' THIRD CONSULTATION PAPER: FEEDBACK ON RESPONSES RECEIVED	Website	en
03.02.2004	REVIEW OF CAPITAL REQUIREMENTS FOR BANKS AND INVESTMENT FIRMS THE TREATMENT OF CIUS IN THE TRADING BOOK AND BANKING BOOK – WORKING DOCUMENT	Website	en
26.11.2003	REVIEW OF CAPITAL REQUIREMENTS FOR BANKS AND INVESTMENT FIRMS THE TREATMENT OF EXPECTED AND UNEXPECTED LOSSES – CONSULTATION NOTE	Website	en
	REVIEW OF CAPITAL REQUIREMENTS FOR BANKS AND INVESTMENT FIRMS COMMISSION SERVICES THIRD CONSULTATION PAPER: COMMENTS RECEIVED	Website	de en fr it da es
01.07.2003	REVIEW OF CAPITAL REQUIREMENTS FOR BANKS AND INVESTMENT FIRMS COMMISSION SERVICES THIRD CONSULTATION PAPER: WORKING DOCUMENT	Website	de en fr
01.07.2003	REVIEW OF CAPITAL REQUIREMENTS FOR BANKS AND INVESTMENT FIRMS COMMISSION SERVICES THIRD CONSULTATION PAPER: EXPLANATORY DOCUMENT	Website	de en fr
07.2003	WORKING PAPER OF THE COMMISSION SERVICES ON THE TREATMENT OF COVERED BONDS :	Website	de en fr

	Comments Received		
07.2003	WORKING PAPER OF THE COMMISSION SERVICES ON THE TREATMENT OF REAL ESTATE LENDING : Comments Received	Website	de en fr
07.04.2003	WORKING PAPER OF THE COMMISSION SERVICES ON THE TREATMENT OF COVERED BONDS	Website	en
07.04.2003	WORKING PAPER OF THE COMMISSION SERVICES ON THE TREATMENT OF REAL ESTATE LENDING	Website	en
04.2003	WORKING DOCUMENT OF THE COMMISSION SERVICES ON CAPITAL REQUIREMENTS FOR CREDIT INSTITUTIONS AND INVESTMENT FIRMS: Comments Received	Website	de en fr it da
18.11.2002	WORKING DOCUMENT OF THE COMMISSION SERVICES ON CAPITAL REQUIREMENTS FOR CREDIT INSTITUTIONS AND INVESTMENT FIRMS: Explanatory Document	Website	de en fr
18.11.2002	WORKING DOCUMENT OF THE COMMISSION SERVICES ON CAPITAL REQUIREMENTS FOR CREDIT INSTITUTIONS AND INVESTMENT FIRMS: Commission Services Working Document	Website	en
05.02.2001	COMMISSION SERVICES' SECOND CONSULTATIVE DOCUMENT ON REVIEW OF REGULATORY CAPITAL FOR CREDIT INSTITUTIONS AND INVESTMENT FIRMS	Website	es de en fr
22.11.1999	A REVIEW OF REGULATORY CAPITAL REQUIREMENTS FOR EU CREDIT INSTITUTIONS AND INVESTMENT FIRMS: Consultation Document	Website	es da de el en fr it nl pt fi sv