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Opinion

Title Impact Assessment on a Commission Directive amending the Capital Requirement Directive On Trading Book, Securitization Issues and Remuneration Policies
(draft version of 14 May 2009)

Lead DG DG MARKT

1) Impact Assessment Board Opinion

(A) Context

Against the background of the international efforts for a coordinated answer to the regulatory weaknesses that transpired during the financial crisis, the European Commission has been proposing a series of amendments to the Capital Requirement Directive. Following a first set of proposals put forward in October 2008 – Com (2008) 602 -, the Commission now intends to propose a set of measures aimed at addressing the capital requirements on trading books, securitization and remuneration issues. This second wave of proposal is the subject of the impact assessment report examined by the Board. A third set of proposals focussing on the need for dynamic provisioning and leverage regulation is planned for Autumn 2009 while further amendments may also be necessary following an expected international agreement on a revised definition of admissible banking capital.

(B) Positive aspects

The report makes a good effort to explain a complex set of problem drivers and analyses a wide range of policy options.

(C) Main recommendations for improvements

The recommendations below are listed in order of descending importance. Some more technical comments have been transmitted directly to the author DG and are expected to be incorporated in the final version of the impact assessment report.

General recommendation: Further work is needed on a number of important issues. The report should strengthen the analysis of the impacts of the proposed measures and better distinguish between impacts and objectives under the current exceptional economic circumstances and under normal cyclical conditions. The report should also be better situated in the context of the on-going EU and

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international efforts to answer the regulatory failures revealed by the financial crisis. Finally, some of the options require clarifications.

During the IAB meeting, DG MARKT stated its intention to take on board these recommendations, and present a revised draft of the impact assessment before the closure of the inter-service consultation. Given the nature of these recommendations, the Board would be ready to examine the revised version of the text before the completion of the decision-making process and issue a new opinion.

(1) More clearly distinguish general from time-bound concerns in the analysis of the problems and in the assessment of the timing of the proposed solutions. The report should more clearly distinguish between its more general objectives in terms of improved regulation over the economic cycle and the specific concerns related to the current economic and financial crisis (notably, worries about the capacity to raise further capital under current market conditions and the fragility of investors' confidence). To achieve this, the report should: illustrate the different notions and sources of excessive procyclicality specifying what is relevant in the specific case under analysis; explain when the proposed measures are expected to be implemented, what the impact on the process of crisis resolution could be and how it would be managed; specify the extent to which the additional capital requirements that would result are meant to address the current perceived lack of capital in the banking sector (and more generally whether the measures proposed are meant to address the causes of the financial crisis only or also its consequences).

(2) Strengthen the analysis of impacts. The report should analyze in greater depth the impact that the proposed measures would have on banks' capital needs, the cost of capital, the availability of credit at the macro level and, more generally, the macroeconomic effects of the proposal. In so doing, the report should be clear about impacts under the normal cyclical conditions expected at the time of entry into force, as opposed to possible impacts under current conditions.

(3) Place the initiative in the broader context. The report should be better situated in the context of the on-going efforts to provide timely answers to the regulatory failures revealed by the financial crisis. In particular, the report should provide a clearer explanation of the scope of the present initiative relative to identified causes of this crisis and the various steps planned by the Commission to address the shortcomings. To this end, a summary table of past and planned measures should be added to the introductory section. For each of the problems addressed, the report should highlight the extent to which the preferred options are in line with the policy choices agreed at the G-20 / Basel Committee level. When international agreement only refers to general principles, the report should make a greater effort to provide information on the differences between the Commission proposals and the implementing measures of other major players highlighting competitiveness and regulatory arbitrage risks whenever relevant.

(4) Better explain some of the proposed solutions. In the case of the capital requirements for the trading book, the report should more clearly indicate whether the key problem addressed is an implicit subsidy in favour of investment in complex securities (notably packaged mortgage loans to US home-owners) arising from the arbitraging opportunities offered by the existing regulations. In this context the report should also explain clearly the conceptual differences between the proposed "stressed VAR" solution and the on-going "stress testing" processes. In the case of re-securitisation risks, the

report should more clearly explain why a re-securitisation can be inherently riskier than a securitisation with the same rating and why changes underway in the regulation of rating agencies are not sufficient to deal with this problem. Finally, in the case of the supervisory review of remuneration policies, the report should better illustrate the interplay, and legal coherence, of the proposed amendments to the capital requirement directive, the Commission Recommendations on remuneration policies in the financial sector and the guidelines issued by the Committee of European Banking Supervisors. The report should also discuss the enforceability of these provisions and clarify their potential impact on banks' employees.

(D) Procedure and presentation

Given the urgency of the initiative and the commitments undertaken in the Commission Communication on Driving European Recovery, the report was submitted to the Board only two weeks before examination. However, an Inter-Service Steering Group was created and stakeholders were consulted. An annex summarising their responses should, however, be added along with an explanation of the reasons why the public consultation period fell short of the mandated 8 weeks.

An impact assessment does not need to identify a preferred option in all cases but this should be made clear whenever the case. From this point of view, therefore, the current position on the policy options for re-securitization should be clarified. Greater clarity would also be welcome with respect to evaluation plans.

Finally, while the Board acknowledges the highly technical nature of the report, it believes further efforts could be made to enhance its readability for non-experts. This should include adding an annex briefly describing the main features of the capital requirement directives as well as extending the coverage of the current glossary of technical terms.

2) IAB scrutiny process

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