Financial markets: banks affiliated to central institutions, certain own funds items, large exposures, supervisory arrangements, and crisis management

2008/0191(COD) - 01/10/2008 - Legislative proposal

PURPOSE : to revise EU rules on capital requirements for banks and amending Directives 2006/48/EC and 2006/49/EC.

PROPOSED ACT : Directive of the European Parliament and of the Council

CONTENT : The Capital Requirements Directive (CRD) comprises Directives 2006/48/EC and 2006/49/EC. This proposal aims to ensure that the effectiveness of the Capital Requirements Directive is not compromised. The revision relates to:

- revisions of rules that were brought forward from previous directives, such as the large
- exposures regime and derogations for bank networks from prudential requirements;
- establishing principles and rules that had not been formalised at the EU level such as the
- treatment of hybrid capital instruments within original own funds;
- clarifying the supervisory framework for crisis management and establishing colleges for
- enhancing both efficiency and effectiveness of supervision.

The revision of certain other areas has been prompted by the financial market turbulence that started in 2007 and is aimed at ensuring adequate protection of creditor interests and overall financial stability. The new rules are designed to reinforce the stability of the financial system, reduce risk exposure and improve supervision of banks that operate in more than one EU country. Under the new rules, banks will be restricted in lending beyond a certain limit to any one party, while national supervisory authorities will have a better overview of the activities of cross-border banking groups.

The main changes proposed are as follows:

Improving the management of large exposures: banks will be restricted in lending beyond a certain limit to any one party. As a result, in the inter-bank market, banks will not be able to lend or place money with other banks beyond a certain amount, while borrowing banks will effectively be restricted in how much and from whom they can borrow. The Commission proposes to limit all inter-bank exposures to 25% of own funds or an alternative threshold of EUR 150 million, whichever is higher.

Improving supervision of cross-border banking groups: the amendments require:

- the establishment of colleges of supervisors to facilitate the tasks of the consolidating supervisor and host supervisors;
- a joint decision on two key supervisory aspects for group supervision (Pillar 2 and reporting requirements) with a last say for the consolidating supervisors. This is coupled with a mediation mechanism in case of disagreement;
- the competent authorities involved in the supervision of a group to consistently apply within a banking group the prudential requirements under the Directive.

The consolidating supervisors will be required to inform CEBS on the activities of colleges to develop consistent approaches across colleges. Colleges will also be required for supervisors overseeing cross-border entities that do not have subsidiaries in other Member States but that do have systemically important branches.

In addition, the rights and responsibilities of the respective national supervisory authorities will be made clearer and their cooperation will become more effective.

Improving the quality of banks' capital: there will be clear EU-wide criteria for assessing whether 'hybrid' capital, i.e. including both equity and debt, is eligible to be counted as part of a bank's overall capital – the amount of which determines how much the bank can lend.

Improving liquidity risk management: for banking groups that operate in several EU countries, their liquidity risk management – i.e. how they fund their operations on a day-to-day basis – will also be discussed and coordinated within 'colleges of supervisors'. These provisions reflect the on-going work at the Basel Committee on Banking Supervision and the Committee of European Banking Supervisors.

Improving risk management for securitised products: rules on securitised debt – the repayment of which depends on the performance of a dedicated pool of loans – will be tightened. Originators and sponsors of the more opaque credit risk transfer instruments retain a proportion of the risk that is being transferred to investors. For this reason, originators and sponsors must retain a material share (not less than 5%) of the risks so that effectively, both originators and sponsors that are regulated by this directive and those that are not will have to retain a share of the risks for their own account. This requirement is complemented by ensuring that investors have a thorough understanding of the underlying risks and the complex structural features of what they are buying. To enable informed decisions, detailed information has to be available to investors.