Access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms. Capital Requirements Directive (CRDIV)

2011/0203(COD) - 20/07/2011 - Legislative proposal

PURPOSE: to ensure the proper functioning of the banking sector and to restore confidence in it.

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

BACKGROUND: Directive 2006/48/EC relating to the taking up and pursuit of the business of credit institutions and Directive 2006/49/EC on the capital adequacy of investment firms and credit institutions have been substantially modified several times. Many of the provisions of these two directives are applicable both to credit institutions and investment firms. To ensure the consistent application of these measures, it is appropriate to merge them in order to create new legislation applicable to both types of entity.

This new legislation will comprise two different legal instruments. In this proposal for a Directive, are the provisions concerning the authorisation of credit institutions and the exercise of the freedom of establishment and of the freedom to provide services. The accompanying proposal for a Regulation establishes uniform and directly applicable prudential requirements for credit institutions and investment firms. This new elements in this proposal comprise provisions on sanctions, effective corporate governance and provisions preventing the over-reliance on external credit ratings.

Sanctions: the sanctions applicable for key violations of the Capital Requirements Directive (CRD), such as authorisation requirements, prudential obligations and reporting obligations, vary across Member States and do not seem always appropriate to ensure sanctions are sufficiently effective, proportionate and dissuasive. Furthermore, there is a certain divergence in the level of application of sanctions in different Member States.

In its 2010 Communication "Reinforcing sanctioning regimes in the financial sector", the Commission has envisaged EU legislative action to set minimum common standards on certain key issues of sanctioning regimes, to be adapted to the specifics of the different sectors.

Corporate governance: strengthening corporate governance is a priority for the Commission, especially in the context of its financial markets reform and crisis prevention programme. The public consultation launched as a result of its Green Paper on corporate governance in financial institutions and remuneration policies demonstrated a broad consensus on the deficiencies of corporate governance standards and practices in the financial services sector. In a resolution, adopted in July 2010, the European Parliament also recognised the importance of strengthening corporate governance standards and practices in financial institutions.

Over-reliance on external ratings: overreliance on credit ratings may lead to herding behaviour of financial actors, e.g. parallel selling-off of debt instruments after that instrument has been downgraded below investment grade, which may affect financial stability. At the international level, the Financial Stability Board (FSB) recently issued principles to reduce authorities? and financial institutions? reliance on external ratings.

IMPACT ASSESSMENT: a series of options was analysed to define the legal framework for sanctioning regimes and corporate governance:

- the options on sanctioning regimes are expected to facilitate detection of violations and to empower competent authorities to apply appropriate sanctions. This is expected to ensure better enforcement of the CRD obligations by credit institutions, which would benefit all stakeholders;
- the preferred policy options improving corporate governance will help avoid excessive risk-taking by credit institutions and lower the risk of failure. It would contribute to the resilience of the banking sector and improve investor confidence The impact on credit institutions and all stakeholders (depositors, shareholders, creditors) should be positive;
- as regards over-reliance on external ratings, the impact assessment of the new initiative on credit rating agencies (planned for early July 2011) will; include a general chapter on over-reliance covered by these proposals.

LEGAL BASIS: Article 53(1) of the Treaty on the Functioning of the European Union (TFEU).

CONTENT: this proposal replaces Directives 2006/48/EC and 2006/49/EC with regard to the coordination of national provisions governing the authorisation of the business, the acquisition of qualifying holdings, the exercise of the freedom of establishment and of the freedom to provide services, the powers of supervisory authorities of home and host Member States in this regard and the provisions governing the initial capital and the supervisory review of credit institutions and investment firms.

Its main objective is to coordinate national provisions concerning the access to the activity of credit institutions and investment firms, the modalities for their governance, and their supervisory framework.

The proposal seeks to ensure the smooth operation of the banking sector and restoring confidence in it by:

- introducing an effective, proportionate and dissuasive sanctioning regime to ensure compliance with the CRD rules;
- development of a level playing field which minimises the opportunities for regulatory arbitrage;
- effective supervision of banking service providers;
- effective corporate governance within credit institutions which should contribute to avoid excessive risk taking.

The main features of the proposal are as follows:

1) Sanctions: with a view to reinforcing and approximating the legal framework concerning sanctions and the mechanisms facilitating detection of breaches, the Directive will require Member States to comply with the following minimum rules:

- make provision for administrative sanctions and measures that are applicable to natural and legal persons responsible for violations, which would include credit institutions, investment companies and individuals, where appropriate;

- in case of a breach, a minimum set of administrative sanctions and measures should be available to competent authorities. This includes withdrawal of authorisation, cease and desist orders, public statement, dismissal of management, administrative pecuniary sanctions;
- the maximum level of administrative pecuniary sanctions laid down in national legislation should exceed the benefits derived from the violation if they can be determined;
- sanctions and measures applied should be published.

Lastly, appropriate mechanism should be put in place to encourage reporting of breaches within credit institutions and investment firms.

2) Corporate governance: with a view to reinforcing the legislative framework regarding corporate governance, the proposal provides for: i) improving the effectiveness of management bodies to oversee risks; ii) improve the stature of the risk management function; and iii) ensure the effective follow-up of risk management by the supervisory authorities.

- The management body of a credit institution or investment firm as a whole should commit sufficient time and possess adequate knowledge, skills and experience to be able to understand the business of the credit institution and its main risk exposures. All members of the management body should be of sufficiently good repute and possess individual qualities and independence of mind which enable them to constructively challenge and oversee the decisions of the management. To avoid group think and facilitate critical challenge, management boards of credit institutions should be sufficiently diverse as regards age, gender, geographical provenance, educational and professional background.
- The management body should be responsible and accountable for the overall risk strategy of the credit institution or investment firm and for the adequacy of the risk management systems, taking into account the credit institution's risk profile.
- Credit institutions and investment firms should have an independent risk management function.

3) Over-reliance on external ratings: overall, the directive seeks to encourage banks to rely on internal ratings rather than external ones to calculate their regulatory capital requirements. In addition, it is proposed that EBA publicly discloses, on an annual basis, information on the steps taken by institutions and by supervisory authorities to reduce over-reliance on external ratings and reports on the degree of supervisory convergence in this regard.

4) Capital buffers: on the basis of Basel III, this proposal introduces two capital buffers on top of the requirements: a Capital Conservation Buffer and a countercyclical capital buffer.

- the Capital Conservation Buffer amounts to 2,5% of risk weighted assets, applies at all times and has to be met with capital of highest quality. It is aimed at ensuring institutions' capacity to absorb losses in stressed periods that may span a number of years;
- the Countercyclical Capital Buffer is set by national authorities for loans provided to natural and legal persons within their Member State. It can be set between 0% and 2.5% of risk weighted assets and has to be met by capital of highest quality likewise. If justified, authorities can even set a buffer beyond 2.5%. The Countercyclical Capital Buffer will be required during periods of excessive credit growth and released in a downturn.

BUDGETARY IMPACT: the proposal has no impact on the Union?s budget.

DELEGATED ACTS: the proposal contains provisions conferring on the Commission the right to adopt delegated acts in accordance with Article 290 of the Treaty on the Functioning of the EU.