Prudential requirements for credit institutions and investment firms. Capital Requirements Regulation (CRR)

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In accordance with the mandates given to the Commission by the European Parliament and the Council, the report aims to evaluate the appropriateness of the rules governing the levels of application of the prudential requirements set out in Directive 2013/36/EU (CRD) and Regulation (EU) No 575/2013 (CRR), in particular the exemption regime.

The report is based on the opinion delivered by the European Banking Authority (EBA) in consultation with national competent authorities on 31 October 2014.

In accordance with the general rule of dual-level supervision, a banking group that is composed of one or more institutions is subject to prudential requirements on both individual and consolidated bases. However, the principle of dual-level supervision is subject to exceptions.

Commissions mandate: the Commissions mandate is to review the application of Part One, Title II and Article 113(6) and (7) of CRR, and report:

- Part One, Title II of CRR specifies the rules for applying on an individual or a consolidated basis all the other prudential requirements set out in CRD and CRR to institutions, including those in cooperative networks and institutional protection schemes.
- Article 113(6) and (7) of CRR specifies the conditions to be satisfied to exempt from liquidity requirements on an individual basis institutions which are members of the same institutional protection schemes or institutions which are linked by a relationship within the meaning of Directive 83/349/EEC on consolidated accounts.

The report sets out the different rules governing the level of application of prudential requirements and discusses the challenges. It analyses the differences, and inconsistencies as well as problems of interpretation. Lastly, it sets out a path to follow.

Recourse to waivers in the EU: the report notes that the use of some waivers appears relatively limited across the EU. Thus:

- only 5 of 28 Member States grant the waiver under Article 7 of CRR, which states that competent authorities in a Member State may exempt a subsidiary or its parent from solvency requirements on an individual basis where the subsidiary and its parent are established in that Member State, are supervised on a consolidated basis and subject to the same risk management framework without obstacles to the transfer of funds;
- only three Member States allow parent institutions to consolidate subsidiaries in accordance with Article 9 of CRR;
- only a small number of group entities are excluded from the scope of prudential consolidation pursuant to Article 19 of CRR;

While appearing of lesser material importance, waivers may strongly influence the structure and internal organisation of EU banking groups and the way competent authorities supervise banking groups. The Commission considers that changes to the existing rules might result in potentially far-reaching adjustments and costs for institutions, competent authorities, and EBA. However, there may be some merit in reviewing the derogation regime in the future to take account of the lessons learnt from the application of the liquidity coverage requirement and the Single Supervisory Mechanism (SSM).

Issues identified: the analysis of the rules governing the levels of application of prudential requirements raises differences, inconsistencies and interpretation issues that merit further consideration:

- differences in the derogations applied to credit institutions and investments firms: the Commission considers that there may be some merit in maintaining less stringent rules for investment firms, given their size, the nature of their activities or their risk profiles. It will be therefore important to understand whether such differentiated treatment could give rise to negative effects;

- no integration of resolution aspects in the rules: the conditions for exempting institutions from prudential requirements on an individual basis do not take resolution aspects into consideration. These conditions could be reviewed in light of the new requirements introduced in Directive 2014/59/EU (BRRD) to maintain coherence between banking resolution and the way banking groups are supervised.

- existence of derogations with inappropriate scope of application: Article 9 of CRR does not allow for exempting institutions from leverage requirements, which is permitted under Article 7 of CRR. It might be worth considering the possibility of better aligning these two articles;

- incomplete conditions for the application of waivers: parent institutions and their subsidiaries may be exempted from prudential requirements on an individual basis under Article 7 of CRR, provided that certain conditions are met. However, there might be some merit in adding further specifications e.g. a control relationship between the parent undertaking and the subsidiaries should be assumed where the parent undertaking has the power to issue binding instructions to its subsidiaries;

- misalignment of exemption rules between CRD and CRR: the levels of application of the internal capital adequacy assessment process (ICAAP) and the prudential rules on governance arrangements, risk management and remuneration policies as set out in Articles 108 and 109 of CRD could be made consistent with the levels of application of the other prudential requirements set out in CRR and CRD.

Together with ICAAP requirements on a consolidated basis, where applicable, the ICAAP could apply on an individual basis to any institution, including those belonging to banking groups, except where competent authorities make use of the derogations under Article 7, 9 or 10 of CRR, taking account of the significance of the institution in relation to the rest of the group.

Amongst the interpretation issues identified are the following:

- risk of divergent interpretation on how to apply remuneration rules on a consolidated basis;
- risk of diverging interpretation of the conditions to the application of waivers;
- unclear treatment of institutions holding participations in financial entities established in third countries.

In conclusion, the Commission does not consider it appropriate to propose amendments to the current rules. It states that it needs to continue to reflect further on the exceptions and conditions for application of the exceptions. Some of these considerations would be particularly apposite in the context of SSM.

Moreover, it is necessary to acquire greater experience with the application of the rules, so that the Commission may carefully assess the feasibility of amending the existing rules.

Before considering the possibility of changing the rules applicable to investment firms, the Commission considers it important to take account of the conclusions of the report on the prudential regime for European investment firms, which the Commission will issue in accordance with the CRR.

Lastly, the experience gained by competent authorities in the implementation of the liquidity coverage requirement and the application of the provisions laid down in the BRRD will contribute to the reflection of the Commission on whether amendments to the application regime for banking prudential requirements would be appropriate.