Vienna, 12 June 2008

Public consultation on possible changes to the Directives 2006/48/EC (CRD) and 2006/49/EC (CAD)

Austrian Comments

Federal Ministry of Finance (BMF)
Financial Market Authority (FMA)
Oesterreichische Nationalbank (OeNB)

The Austrian Federal Ministry of Finance, the Austrian Financial Market Authority and the Oesterreichische Nationalbank (Central Bank of Austria, OeNB) welcome the opportunity to contribute to the envisaged changes of the CRD and CAD and would like to comment on the European Commission's Consultation Paper as follows:

A. ad Large exposures

Article 106 CRD

Article 106 (1) last subparagraph CRD mirrors the provision in Article 66 (3) CRD. Therefore it should contain a reference to Article 57 (q) **and (r)** and to Article 63 (3) CRD.

Article 110 para. 1 CRD – reporting

- Gross values should always be reported, therefore the phrase "to the extent possible" in Art. 110 para. 1 lit. b should be deleted.
- As regards reporting of the 20 largest exposures, we recognize the importance for countries without credit registers. Therefore, we would like to reiterate our understanding of the European Commission's proposal that the proposal does not intend to create additional reporting obligations where information about the 20 largest exposures is already available from those registers.

Article 110 para. 2 CRD – reporting frequency

<u>Reporting should be carried out at least four times, not only twice a year.</u>

A well-functioning reporting framework is one of the pillars of efficient and effective bank supervision. To this end, we suggest rewording the proposed Article 110 (2) CRD to ensure a more prudent treatment throughout the Member States:

"2. Member States shall provide that reporting of all large exposures is to be carried out at least four times a year."

Article 110 para. 3 CRD – analysis of indirect exposures

<u>We oppose the inclusion of the phrase "*to the extent possible*" into paragraph 3</u>.

Including this phrase would introduce a more or less subjective element to the obligation of credit institutions to analyse their indirect exposures for possible concentrations and thereby weaken this obligation. Furthermore the phrase could lead to different interpretations and, as a consequence, to a different supervisory treatment within the member states. Therefore we suggest amending the provision as follows:

> "3. Member States shall ~~may~~ require credit institutions to analyse ~~to the extent possible~~ their exposures to collateral issuers and providers of unfunded credit protection for possible concentrations and where appropriate take action or report any significant findings to their competent authority."

INTERBANK EXPOSURES

In view of the concerns set out below, Austria urges the European Commission to retain the current regime for interbank exposures, with exemptions based on maturities (Art. 111 para. 1, Art. 113 para. 3 lit. i and Art. 115 para. 2) and the exemption for claims on central institutions (Art. 113 para. 3 lit. n) as it stands now.

Article 111 CRD

With regard to the proposed changes to the provisions on interbank exposures we would like to put forward the following reservations:

- Any limitation of interbank exposures constitutes a massive change of the current large exposure regulation and should not be done without a solid assessment of costs and benefits associated with it. Such an in-depth impact analysis has yet to be performed. It should also be borne in mind that the current provisions for interbank exposures in Art. 113 (3) lit. i, Art. 115 (2) and Art. 116 CRD have only recently been introduced. An evaluation of their functioning is still outstanding as well.
- A limitation of interbank exposures may lead to a (further) restriction of liquidity for all kinds of banks. Especially against the background of the current situation in the financial markets such a measure seems to be the wrong way forward.
- The restrictive impact of a limitation of interbank exposures could be amplified by the combination with other proposed changes of the current large exposure regime, e.g. the extension of the definition of connected clients or the deletion of lower weightings for certain off-balance sheet items.

- Furthermore, the access of small credit institutions, which are heavily reliant on a very restricted number of possible counterparts, to the financial markets may be seriously impaired by the proposed amendment.
- Restricting the liquidity transfers between banks may impact heavily on the scope and quality of banks' business as the lack of counterparts would render further transactions impossible as soon as the limit is reached with the available counterparts.
- Austria, like a number of other Member States, has not made use of the waiver in Art. 69 and 70 CRD so that the large exposure regime is equally applicable on the solo and the consolidated level. A well-defined EUR [X]-limit would have to fit the smallest and the largest institutions likewise. In addition, decentralized sectors with their small credit institutions have to be taken into account, which makes it exceedingly difficult, if not impossible, to determine the adequate amount.
- Finally, we believe that if combined with appropriate supervisory tools (frequent reporting etc), the current regime does not give rise to supervisory concerns.

Article 113 para. 3 lit. i CRD (present version) – short-term interbank exposures

We strongly <u>oppose the deletion</u> of the exemption for short-term interbank exposures.

The possibility to exempt short-period interbank exposures from Art. 111 (1) CRD is essential for the liquidity management of credit institutions. The introduction of an additional threshold (i.e. amount X) for large exposures in Art. 111 CRD is not deemed to be an adequate alternative for the deletion of Art. 113 (3) lit. i CRD (present version).

Article 113 para. 3 lit. n CRD (present version) – exemption of claims on central credit institutions

The <u>retention of the exemption</u> of claims on central credit institutions (currently Art. 113 (3) lit. n CRD) is of <u>utmost importance for the decentralised banking sectors</u> in Austria.

- Since its transposition into Austrian Banking law, this exemption has proven its merits by providing for a stable, and well-functioning, system of liquidity supplies within the decentralised sectors.
- In the recent turmoil, members of decentralized sectors have remained largely unaffected by the liquidity shortage in the interbank market. Functioning liquidity reserve systems therefore contribute to the stability of the financial markets and the

continuous supply of banking services, especially to local/regional SME and retail clients.

- Most decentralized banking sectors have contractual regulations for the settlement of liquidity which contribute to the legal certainty associated with these systems. Austria even implemented a legal obligation in this respect the reasonableness of which has only recently been confirmed by the European Commission itself, recognizing the liquidity pooling in decentralized sectors as necessary and useful.
- If the exemption for claims on central credit institutions is deleted, most of the liquidity would have to be distributed outside the sector and this would gravely impair the functioning of the stable liquidity-pooling and cash-clearing systems within decentralized sectors.
- The proposed extension of the intra-group provision by including institutions fulfilling the conditions in Art. 80 (8) CRD in the intra-group exemption would not substitute for the deletion of Art. 113 (3) lit. n CRD. While some decentralised sectors might not fully comply with Art. 80 (8) CRD, all the existing contractual systems of liquidity settlement fulfil the requirements of Art. 113 (3) lit. n CRD. The proposed amendment would therefore privilege the systems compliant with Art. 80 (8) CRD over the competing systems and, hence, would have far-reaching structural implications.
- Moreover, it should be borne in mind that intrasectoral liquidity-settlement systems and institutional guarantee schemes according to Art. 80 (8) have different – overlapping, yet not fully congruent – objectives: the former serve to ensure a sufficient liquidity supply, whereas the latter contribute to avoid bankruptcies.

INTRA-GROUP EXPOSURES

Article 113 para. 1 lit. f CRD

Instead of the proposed new Art. 113 (1) lit. f, we advocate the implementation of CEBS' proposal to keep the national discretion in Art. 113 (2) CRD and extend it to Art. 80 (8) CRD. From our point of view keeping Art. 113 (2) CRD and extending it to exposures that meet the conditions of Art. 80 (8) CRD would be a better solution than the European Commission's suggestion, as we cannot see any additional value in referring to Art. 80 (7) CRD and thereby restricting conditions for a usage of the intra-group exposures' exemption instead of keeping the current exemption in Art. 113 (2).

Article 113 para. 3 lit. e CRD (present version)

We oppose the general deletion of the exemption for claims on central governments and central banks of third countries.

A possibility to fully or partially exempt claims on central governments and central banks outside the EU, which are denominated and funded in the national currencies of the borrowers, from the large exposure limit should be kept.

At all events a possibility should be kept for credit institutions to fully or partially exempt from the large exposure limit the minimum reserves required to be held by credit institutions at a central bank which would not be assigned a 0% risk weight under the Standardised Approach.

Article 113 para. 3 lit. r and t CRD (present version) – off-balance sheet items

We advocate the retention of the current 50%-risk weight for medium/low-risk items in Art. 113 (3) lit. r and the exemption for low-risk items in Art. 113 (3) lit. t.

We believe a general 100 % Credit Conversion Factor (CCF) for all off-balance sheet items without any graduation to be inappropriate. Risk graduations for off-balance sheet items have a long and successful history and have been at least in part applied by a large majority of Member States. Introducing general 100%-CCFs now may lead to a further tightening of credits.

Article 113 para. 2 CRD – covered bonds

We welcome the proposed possibility to further exempt covered bonds.

With regard to the European Commission's endeavour to reduce national discretions and the over-riding goal of a more harmonised regulation we suggest making Art. 113 (2) a mandatory exemption.

Article 114 CRD – Credit Risk Mitigation

In general we welcome the European Commission's proposal on the recognition of Credit Risk Mitigation (CRM) techniques. However, we would like to point out that Art. 112 and Art. 114 – 117 in the proposed version still contain a number of inconsistencies in respect of the applicable methods and the types of recognized securities.

In any case the option in Art. 114 para. 4 should be kept. We do not see a reason why an assignment of the collateralized part of an exposure to the collateral issuer should not be possible in the future when applying the Financial Collateral Comprehensive Method or the approach set out in Art. 114 para. 2 CRD, particularly as all other credit institutions have this possibility under Art. 117 para. 1 CRD.

B. ad Hybrid Instruments

Article 63a lit. a (third subparagraph) CRD – permanence

We recommend another wording of the phrase „*...and either financial or solvency conditions of the credit institution are not affected.*" as we fear that such a phrase in the directive, especially when translated into other languages, could lead to misunderstandings and imply that it is sufficient if only one of the two conditions mentioned (financial or solvency) is not affected.

Therefore we suggest changing that phrase as follows:

„...and neither financial nor solvency conditions of the credit institution are affected."

Article 63a lit. c CRD – loss absorption

We support the wording in lit. c as proposed by the European Commission.

Article 66 para. 1a CRD – limits

We urge the European Commission to reinstate a provision on the minimum level of core original own funds.

The limitation of hybrid instruments as it stands now would allow credit institutions to reduce their core original own funds down to 25 % of the minimum capital requirements, which is too low from our point of view. We would therefore support an inclusion as follows:

"The total of the items in points (a) to (c) minus (i) to (k) of Article 57 shall be equal to at least 35% of the sum of minimum capital requirements set out in points (a), (c) and (d) of Article 75 and the items in points (l) to (r) of Article 57."

Article 66 para. 1a point d CRD

We welcome the provision stating that hybrid instruments exceeding the limits according to Art. 66 para. 1a can be treated as upper Tier II-capital.

Article 154 para. 8 CRD – Grandfathering

1. We suggest rewording the provision along the lines of Article 84 (5) CRD.

We recognise the need to provide for a flexible solution for those institutions that, at the date of entry into force of the CRD amendment, do not comply with the limits provided for hybrid capital. However, the Austrian banking law as well as the overriding constitutional principles do not allow public authorities to simply disregard a violation of the law. Strictly speaking, the FMA would hence be required to initiate proceedings against any non-compliant institution.

In order to achieve the intended aim, Art. 154 para. 8 should therefore read as follows:

"8. Credit institutions which do not comply at [the date of entry into force] with the limits laid down in Art. 66 para. 1a shall present to the competent authority a reasonable and suitable plan for the timely compliance with these limits before the dates indicated in point 9 below. The plan shall detail the measures to be taken by the credit institution and an indication as to the time limits within which compliance shall be achieved."

2. As regards the phrase *„...the dates indicated in point 9 below...*" it remains unclear which dates para. 8 is exactly referring to. We understand para. 8 applying to hybrids complying with the criteria set out in Art. 63a CRD as well as to instruments covered by the grandfathering provision according to Art. 154 (9) CRD. As there are three different dates in para. 9 the question arises how the three „deadlines" are applicable to those hybrids meeting the requirements in Art. 63a. The provision may enable a credit institution to exceed a limit set out in Art. 66 (1a) CRD for up to 30 years.

Annex XII, part 2, point 3 (a) and (b) CRD

In both points the reference to Art. 154 paragraph (8) is incorrect and has to be changed to Art. 154 paragraph **(9)**.

C. ad Supervisory arrangements

General remark

We suggest introducing a recital which explicitly states that the CRD-amendment in the field of supervisory arrangements does not intend to re-allocate responsibilities between the home and the host supervisors. This was confirmed by the Commission Services several times and can now be found in the Commission's introductory text to the section on supervisory arrangements of the Consultation Paper as well. However, discussions in different fora have repeatedly shown a lot of misunderstandings in this regard, which is why we would welcome an explicit clarification not only in explanatory side notes, but in the Directive itself.

Article 40 para. 3 CRD – regard to financial stability in other Member States

We strongly oppose the proposed introduction of a new para. 3 into Art. 40 stipulating that the competent authorities in one Member State shall have regard to (respectively shall consider) the potential impact of their decisions on the financial stability of the financial system in all other Member States concerned.

The proposed Article 40 (3) raises a number of important issues:

- It is unclear what the precise legal effects of this provision - which is referred to as an "obligation" in the proposed Article 129 (3) – would be on the Member States and their competent authorities. In particular, the consequences on liability claims vis-à-vis the competent authorities across Europe need to be assessed carefully before considering incorporating such a norm within the body of a directive. Please note that, at present, liability regimes vary significantly across the EU. The inclusion of such a provision should not give rise to any form of "forum shopping" by (wronged) investors.
- Moreover, it remains unclear what effect the proposed wording would have on the operations of national competent authorities. Supervisors should undoubtedly

consider the overall implications of their decisions. However, measures in emergency situations need to be taken swiftly and without undue delay. Their efficiency and effectiveness should not be compromised by the need to comprehensively assemble all data relevant for the appraisal of all potential implications in all Member States concerned or by the need to give a correspondingly detailed reasoning to any measure taken.

- Additionally, it cannot be ruled out that Member States' views on the impact of measures on the financial stability in the different jurisdictions may differ, which – under the proposed regime – may again not only hinder effective crisis solutions, but also raise difficult legal issues.

The proposed Article 40 (3) therefore seems both insufficiently determined and would result in significant practical difficulties. We therefore advocate its removal from the current draft text or at least its shift to the recitals of the proposed Directive.

Article 49 CRD – information to central banks

We recommend rewording the proposed last subparagraph in order to provide more clarity to the provision on communication of information to central banks in the EU:

- We deem the general reference to "respective statutory tasks" of central banks too undetermined. It is not clear which tasks are meant to be covered in particular. The transposition of such an undetermined provision would be in contradiction to the Austrian constitutional principle of legality.
- From our point of view it is sufficient to only refer to all the central banks' functions already explicitly mentioned in this subparagraph, as any other relevant tasks could be subsumed under these far-reaching areas of responsibility.
- To this end we suggest to only refer to tasks in the conduct of monetary policy, the oversight of payments and securities settlement systems, and the safeguarding of financial stability.
- Moreover, we would suggest allowing the competent authorities to communicate (subject to their discretion) information to central banks for financial stability purposes also in normal times, given that this would benefit the cooperation in the area of crisis prevention.

"In an emergency situation as referred to in Article 130(1), Member States shall allow competent authorities to communicate information to central banks in the EU when this information is relevant for the exercise of tasks in the conduct of monetary policy, the oversight of payments and securities settlement systems, and the safeguarding of financial stability. In addition, Member States shall allow competent authorities, subject to their discretion, to communicate information to central banks for financial stability purposes also in normal times."

Article 129 para. 2 subpara. 5 CRD – approval of internal methods

<u>We do not support the proposed introduction of a new subparagraph in para. 2.</u>

- Firstly, we oppose a formal introduction of mediation in the Directive text. In any case, we have <u>major concerns</u> regarding the proposed requirement that the consolidating supervisor shall consult CEBS at the request of the applicant in the course of a cross-border model approval process, even if a joint decision would be possible within six months. The possibility for an applicant to oblige the consolidating supervisor to consult CEBS is also <u>not in line with the common understanding achieved on the mediation framework and laid down in CEBS' Mediation Protocol</u>, leaving it at the discretion of each CEBS authority to admit the request of a market participant and initiate the mediation or to turn it down. Moreover, applications usually contain important amounts of documentation (extending to several thousand pages) and concern highly complex issues, which often have been discussed over lengthy pre-consultation periods with the authorities. For this reason we feel that it may often be <u>impossible for CEBS members that are not involved in the process to assess potentially disputed issues.</u>
- Secondly, besides these general concerns, the proposed provision may also cause <u>technical problems in the approval process</u>. The current draft does not take into account that CEBS might not provide an advice within the proposed two months' extension. Thus, either CEBS would have to be obliged to provide its advice within two months while otherwise the approval process could be continued as if there had not been any mediation process, or the extension would have to be linked to the length of each individual mediation process. A simple general extension of two months would not be appropriate. In any case there must be a provision ensuring that the competent authorities will have enough time to take the CEBS advice into consideration when finalising their well-reasoned joint decision.

- Thirdly, please note that our experiences with the existing procedural framework according to Article 129 para. 2 CRD (present version) have been very positive. To our mind the current decision-making mechanism works to the satisfaction of all parties and provides for a timely (and cost-effective) decision. We are therefore reluctant to support amendments to a well-tried formula. The addition of another procedural layer may complicate the process without ensuring a speedier, or easier, decision-making.

Article 129 para. 3 subpara. 1 CRD – colleges of supervisors

We oppose an explicit obligation of CEBS to elaborate guidelines for the functioning of colleges in the directive text.

- The role of CEBS can be sufficiently described in the Directive's recitals and there is no legal necessity to include such a provision in the directive text.
- Furthermore, potential adverse interpretations of such a provision must be carefully considered, meaning that including an explicit reference to CEBS guidelines at one place in the directive may raise questions in areas where guidelines of Level 3-Committees already exist or are planned without direct reference to them in a directive text. We therefore suggest deleting the last sentence in Article 129 (3) subpara. 1.

Article 129 para. 3 subpara. 2 CRD – participants in colleges

We suggest rewording the first sentence in Art. 129 (3) subpara. 2.

The way we read Art. 129 (3) subpara. 2, its first sentence intends to describe those authorities which can participate in a college of supervisors principally and the second sentence refers to the group of participants in a specific meeting or activity of a college, which is decided ultimately by the consolidating supervisor. To avoid contradictions between those two sentences by granting a general right to participate to all authorities mentioned, and taking this right again by leaving the decision to the consolidating supervisor, we suggest the following wording:

"Participants in colleges of supervisors can be competent authorities responsible for the supervision of subsidiaries of an EU parent credit institution or an EU parent financial holding company and the competent authorities of a host country where systemically relevant branches are established."

Article 129 para. 3 subpara. 4 CRD – tasks of colleges

- We understand from Commission services statements that „to reach an agreement" does not mean to reach a joint decision as referred to in para. 2, but rather that competent authorities should discuss the application of Articles 72 (2), 74 (2), 113 (1) (f) and 136 (2). However, if this is the intention, then the subparagraph should be reworded accordingly. We would also like to note that we could not agree with any other interpretation of this paragraph.
- The general concerns regarding the formal introduction of a mediation mechanism expressed in the comment to the proposed Article 129 (2) CRD also apply in this context. Moreover, in contrast to Article 129 (2) CRD, there is no need to achieve a joint decision on the application of the mentioned articles, which further questions the appropriateness of a mediation mechanism in these particular cases.
- Finally, we strongly argue for deleting the reference to Article 136 (2) CRD (i.e. own funds requirements in the excess of the minimum level). Article 136 (2) concerns the imposing of sanctions to individual institutions and not the general application of certain provisions. Thus, due to its nature Article 136 (2) is not suitable for the proposed approach.

Article 129 para. 3 subpara. 5 CRD – information to CEBS

We advocate the deletion of the fifth subparagraph stipulating that the consolidating supervisor shall inform CEBS of the activities of the college of supervisors as we cannot identify the purpose of the reporting. Moreover, the scope of information to be reported remains unclear. By virtue of these uncertainties and taking into account the number of potential colleges we fear an unmanageable information overflow that will cause substantial costs (cost-benefit ratio?).

Article 38 para. 3 CAD

The phrase "*..with the exception of its third subparagraph...*" has to be replaced by "*with the exception of the second sentence of its second subparagraph.*" in order to exclude a mandatory assessment of market shares of branches in terms of deposits.

D. ad Waivers for cooperative bank networks and other technical amendments

Article 150 para. 1 lit. m CRD – comitology

We oppose the proposed introduction of comitology procedure for the 25%-limit for large exposures in Art. 111 (1) CRD. This limit is a key point of the large exposure regulation, any alteration would be a political question and therefore require an agreement in the co-decision procedure. Thus, the phrase "and the percentages" is to be deleted.

Article 87 CRD – Collective Investment Undertakings

We recognise the technical difficulties associated with a full look through and welcome the Commission's initiative to address the concerns raised by the industry. However, we have some reservations about the alternative approach as put forward by the Commission services.

The proposed modifications to the risk weighting do not reduce the administrative burden inherent in operating a full look through. Instead, the proposed changes serve to reduce the costs incurred under the current treatment (Standardised Approach plus one notch). Therefore the proposal does not address the initial (operational) concerns related to the implementation of the look through and may also create a negative incentive against implementing a full look through.

Furthermore we would welcome more analysis on the appropriate size of the multipliers.

E. ad Technical amendments to Directive 2006/48/EC

Annex VI, Part 2, Point 1.4.7 CRD

While we support the intention expressed by the proposed amendment, it is not clear how this provision could be enforced in practice by the supervisory authorities.

Annex IX, Part 2 CRD

In the introductory sentences of points 1.1. and 2.2. reference is made to "holding a securitisation position". Since in evaluating the significant risk transfer special attention has to be paid to the securitisation positions which are held by the originator credit institution, a precise definition of "holding a securitisation position" might be desirable in order to clarify the scope of application of the respective provisions. For example: "Holding a securitisation position means that the securitisation position is held by the originator credit institution itself or a subsidiary."

Further, in the fourth subparagraph – concerning the case-by-case decision on a significant risk transfer – it is required that the originator credit institution has to demonstrate that the transfer of credit risk to third parties is also assumed for purposes of the credit institutions internal risk management and its internal capital allocation. It is questionable why the relevance of the significant risk transfer for internal purposes is only stipulated for this particular case, but not for the regular assessment of a significant risk transfer. We would thus suggest introducing this condition as general requirement and to transfer it to Annex V.

We understand that the last sentence under points (a) and (b) respectively, starting with "*In addition, all of the following conditions shall be met: …*" applies in all cases and not only in the context of a case-by-case decision. This should be clarified by correcting the indention of this sentence and maybe also by a change in the wording.

Annex IX, part 4 CRD

Corresponding to the deletion of point 56, in point 59 the sentence "*If the liquidity facility complies with the conditions in point 56 a conversion figure of 20% may be applied.*" would have to be deleted as well.

Annex X, part 2, point 1.1 CRD

In our opinion, technically the proposed wording is still not fully correct. We would therefore propose a redrafting as follows:

"Under the Standardised Approach, the capital requirement for operational risk is calculated as the three-year average of the yearly summations of the risk-weighted sums of net interest income and net non-interest income across business lines referred to in Table 2. In any given year, negative values (resulting from negative gross income) in any business line may offset positive values in other business lines without limit. However, where the sum of values across all business lines within a given year is negative, the input to the numerator for that year will be zero."

F. ad Technical amendments to Directive 2006/49/EC

Annex I, point 14, Table 1 CAD

In table 1 (second row, first column), the current – from the proposed amendments not affected – reference to "*debt securities issued or guaranteed by institutions which would qualify for credit quality step 3 under the rules for the risk weighting of exposures under point 28, Part 1 of Annex VI to Directive 2006/48/EC*" should be amended, since point 28 does not contain any credit quality steps. Given that the treatment (risk-weighting) of exposures to institutions depends on whether the central government risk weight based method or the credit assessment based method is applied, we would consider a general reference to the standardised approach most appropriate in this context.