

*Ing. Milan ŠIMÁČEK*  
*Deputy Minister*

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*Ref:27/51 667/2008*

*Dear David,*

*The Ministry of Finance of the Czech Republic welcomes the Commission consultation on potential changes to the Directives 2006/48/EC and 2006/49/EC. Overall, we appreciate the work done in this very important area and view favourably the general direction of many of the proposed changes.*

*We support the clarification and simplification of the large exposures regime and believe that it is useful to create a more efficient supervisory framework which fosters better cooperation, exchange of information as well as further convergence in supervisory practice. We also welcome the Commission's proposal to harmonize the definition of own funds in the area of hybrid capital instruments.*

*At the same time, however, we would like to share some serious concerns regarding the detail of the proposed changes that touch upon the regulation of intra-group exposures as well as the the functioning of proposed colleges of supervisors. In both areas a better balance needs to be struck which takes into account the specific position of those Member States whose banking sector is dominated by large subsidiaries of EU parent institutions.*

*In particular, doing away with Member State discretion to impose limits on cross-border intra-group exposures may undermine the ability of some Member States to maintain stability of their financial system. There may be a trade-off between achieving efficiency of exposure management at the group level and maintaining soundness of individual group members which, in our view, is not adequately addressed in the draft legislative text. If the intra-group*

- exposures regime were to be liberalised as currently proposed, adequate regulatory safeguards should be built into any final solution so that the possibility of cross-border transfer of capital within a group does not result in the increase of vulnerability of systemically important subsidiaries.

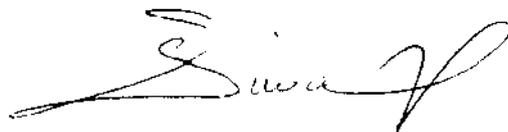
As far as the proposed organisation and functioning of the colleges of supervisors is concerned, we are afraid that an approach which is overly prescriptive and which introduces unclear legal obligations on supervisors may not only impede the efficiency of the colleges' functioning but also contribute to the divergence in supervisory practice in the EU. To be precise, obliging supervisors to agree within a college on a common application of a certain number of articles may unify the application of the directives across a single banking group, but it may result in the fragmentation of supervision globally as well as at the Member State level.

- For example, as a result of the proposed changes, supervisors in Member States where a small number of large subsidiaries dominate the financial market could find themselves receiving different and incomparable information from the institutions they oversee, depending on which group those institutions belong. Not having a reliable overview over one's market would certainly reduce the competent authority's essential supervisory role. In this sense, it would be much preferable to seek a workable EU-wide rather than a group-wide solution.

Attached you will find more detailed comments including proposed changes to the legal text. I hope that you find them useful and look forward to our ongoing cooperation.

Sincerely yours,

Annex



Ministry of Finance of the Czech Republic comments regarding proposed changes to the Directive 2006/48/EC and 2006/49/EC

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# **Ministry of Finance of the Czech Republic comments regarding proposed changes to the Directives 2006/48/EC and 2006/49/EC**

## **Large exposures**

### ***1. Reporting of 20 largest exposures***

The Commission proposes that credit institutions making use of the IRB approach report the 20 of their largest exposures. The reporting of the 20 largest exposures should not be limited only to IRB banks as there appears to be no significant administrative burden associated either with reporting the list of exposures by the credit institution (the institutions have this data anyway) or on the side of the regulator for whom the list of 20 largest exposures may represent a good quick and succinct overview of an institution's exposure risk.

### ***2. Interbank exposures***

We suggest including a Member State discretion to partially exempt exposures to institutions. The Commission proposal does not include such an option.

We would propose to maintain an exemption which operates with relative values so that distortions due to market size and systemic relevance of relatively small banks (in absolute value) in certain Member States are not introduced (see the draft text proposal).

### ***3. Intragroup exposures***

We are strongly against having a system which could potentially result in credit institutions having no limits on intragroup exposures, especially in respect to cross-border financial groups. Such a proposal could potentially jeopardise financial stability in the Czech Republic.

The efficiency of a group exposure management can indeed be increased (through elimination of intra-group large exposure limit) but only at the expense of potentially concentrating risk and increasing vulnerability of individual group members. This could even result in a spillover of crises from one Member State's market into another one. The mitigation of the mentioned implications could present – under stressed conditions - the additional significant costs (e.g. provision of Emergency liquidity Assistance or funds from deposit-guarantee scheme, etc.) to Member States' taxpayers.

Although, the elimination of intra-group large exposure limits could increase the efficiency of the allocation of fund surpluses throughout the group, we are deeply concerned about the increase in systemic risk associated with uncontrolled flow of capital across borders.

Wholesale counterparties – being aware of no or (potentially) high intra-group limits – would react in our opinion more sensitively to any „bad news“, or rather rumours concerning none but one entity belonging to the same group as a borrowing bank (regardless of the national market on which a hit entity operates or is incorporated). In this connection there is a major threat that lenders outside the group would automatically increase the borrowing costs (or even cut credit lines) for a bank inside a group as a consequence of a failure of any entity belonging to the given group. The reason for such behaviour is given by the fact that the

lenders would run the risk that just its borrower is excessively exposed (directly/indirectly) to the distressed entity.

In this way, we suppose, the contagion could spread more easily throughout the group and concurrently throughout the individual (national) interbank markets across EU than it is the case of the current regime (provided that there are no safeguards introduced) under which the intra-group exposure to another (potentially stricken) entity may be limited.

## **Supervisory arrangements**

### ***1. Regard to the financial stability in other Member States***

The Commission proposes that, when making decisions, competent authorities must have regard to the impact of their decisions on the stability of the financial system in all other Member States. We fear that, as currently drafted, such a provision would not only be impracticable but could also seriously undermine legal certainty of the decisions taken by all competent authorities.

The proposition would be impracticable as it imposes an obligation to have regard to financial stability in all other member states in all decision making of the competent authorities. The fact that such attention is to be particularly heightened in emergency situations does not take away the general obligation to do so at all times. Instead of fostering financial stability in the EU, this could potentially lead to an imposition of undue administrative burdens on competent authorities.

Furthermore, even if a provision of a directive does not give rights to private persons to enforce the provision in national courts, the decisions of our supervisors involving private persons are subject to challenge in courts.

The courts may overrule the decision of the supervisor in case the supervisor does not act in line with his legal obligations. If we were to transpose the text of the directive, we would create an obligation for the supervisor that would have to be followed in times of crisis and could subsequently be used by parties subject to formal supervisory decisions to challenge and overturn such decisions with potentially grave financial consequences not just supervisors for but also state budgets.

We therefore suggest moving the text of the proposed paragraph 40(3) into a recital of the directive.

### ***2. Determination of a systemically relevant branch***

We strongly support the policy of having the host supervisor have the last say in the determination of a systemically relevant branch. The process should also be clearly defined in the directive so all actors concerned may have adequate legal certainty in their dealings with one another.

This is why we propose slight drafting changes to the Commission text which stipulates that when the host supervisor believes that a certain branch should be deemed systemically relevant, he notifies the home supervisor and informs him of that opinion. If both of the

supervisors do not reach an agreement within three months, the host supervisor should make his own decision.

Finally, a procedural addition is deemed necessary so that in the absence of a joint determination it is clearly specified that the host supervisor must make his own determination.

### **3. Establishment and functioning of colleges of supervisors**

The Czech Republic welcomes the formal establishment of colleges in the directive in so far as their regulation entails

- greater legal certainty and clarity of their operations
- greater effectiveness and efficiency of supervision of institutions active cross-border
- convergence of supervisory practices at EU level.

This is why we propose a series of amendments to the legal text. The drafting changes proposed have been guided by several important considerations:

- There is only **one college of supervisors per group** at the consolidated level in the EEA
- **Membership** of the college is clearly defined in the directive as containing:
  - consolidating supervisor
  - competent authorities responsible for the supervision of subsidiaries of an EU parent credit institution or an EU parent financial holding company
  - competent authorities of a host country where systemically relevant branches are established
- **Effectiveness and efficiency** of the colleges' operation is ensured via
  - the possibility of the consolidating supervisor to set up ad hoc or standing groups depending on the activities and allocation of tasks
  - information to members of the college on the purpose and mandate of such ad hoc and standing groups
  - reporting of ad hoc and standing groups to the college
- **There is no transfer of powers towards the consolidating supervisor.** We strongly support a clear and explicit provision in the body of the directive stating that the activities of colleges must be without prejudice to the powers given to competent authorities elsewhere in the directive. It implies that colleges should provide, in the wording of the EU Council conclusions of 14 May 2008, "a platform for a decision-making process where appropriate".

However, we believe the proposed legal text appears to make colleges into "places of decision-making" where college members are given a prescribed list of what is appropriate to decide upon. As was described in our general comments above we do not believe that colleges should have a defined set of Articles on whose application they should reach an agreement.

Obliging supervisors to agree on the application of articles which may have been transposed in their national legislation in a divergent manner may be beyond the supervisors powers and thus unnecessarily burdensome for the operation of colleges. Furthermore, as a result of the proposed changes, supervisors in Member States where a small number of large subsidiaries dominate the financial market could find themselves receiving different and incomparable information from the institutions they oversee, depending on which group those institutions belong.

Not having a reliable overview over one's market would certainly reduce the competent authority's essential supervisory role and could be a step backwards in the drive to provide Europe with a better supervisory framework.

- Obligation to **regularly** inform the Committee of European Banking Supervisors on the activities of the college.

# Proposed amendments

## Reporting of 20 largest exposures

### Article 110

1. A credit institution shall report the following information about every large exposure to the competent authorities, including those exempted from the application of Article 111(1):

a) the identification of the client or the group of connected clients to which a credit institution has a large exposure;

b) the exposure value before taking into account the effect of the credit risk mitigation, to the extent possible;

c) where used, the type of funded or unfunded credit protection;

d) the exposure value after taking into account the effect of the credit risk mitigation calculated for the purpose of Article 111(1).

A credit institution shall report its 20 largest exposures on a consolidated basis, excluding those exempted from the application of Article 111(1), to the competent authorities where such information is not available to the competent authorities by other means.

~~2. Member States shall provide that reporting is to be carried out quarterly, at their discretion, in accordance with one of the following two methods:~~

~~(a) reporting of all large exposures at least once a year, combined with reporting during the year of all new large exposures and any increases in existing large exposures of at least 20 % with respect to the previous communication; or~~

~~(b) reporting of all large exposures at least four times a year.~~

~~2. Except in the case of credit institutions relying on Article 114 for the recognition of collateral in calculating the value of exposures for the purposes of paragraphs 1, 2 and 3 of Article 111, exposures exempted under Article 113(3)(a) to (d) and (f) to (h) need not be reported as laid down in paragraph 1 and the reporting frequency laid down in point (b) of paragraph 1 of this Article may be reduced to twice a year for the exposures referred to in Article 113(3)(e) and (i), and in Articles 115 and 116.~~

~~Where a credit institution invokes this paragraph, it shall keep a record of the grounds advanced for at least one year after the event giving rise to the dispensation, so that the competent authorities may establish whether it is justified.~~

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 ~~and~~ report any significant findings to their competent authority.

## Inter-bank exposures

### Article 111

1. A credit institution may not incur an exposure, after taking into account the effect of the credit risk mitigation in accordance with Articles 112 to 117, to a client or group of connected clients the value of which exceeds 25 % of its own funds.

(i) Where an exposure is incurred to an institution, Member States may exempt up to X % of the exposure value from the application of this Article.

## Alternatively

Member States may provide that exposures to institutions represent up to Y% of the credit institution's own funds (where Y is greater than 25%).

## ***Intra-group exposures***

### *Article 113*

- ~~1. Member States may impose limits more stringent than those laid down in Article 111.~~
- ~~2. Member States may fully or partially exempt from the application of Article 111(1), (2) and (3) exposures incurred by a credit institution to its parent undertaking, to other subsidiaries of that parent undertaking or to its own subsidiaries, in so far as those undertakings are covered by the supervision on a consolidated basis to which the credit institution itself is subject, in accordance with this Directive or with equivalent standards in force in a third country.~~

13. Member States may fully or partially exempt ~~†~~The following exposures shall be exempted from the application of Article 111(1):

(a) asset items constituting claims on central governments or central banks which, unsecured, would be assigned a 0 % risk weight under Articles 78 to 83;

(b) asset items constituting claims on international organisations or multilateral development banks which, unsecured, would be assigned a 0 % risk weight under Articles 78 to 83;

(c) asset items constituting claims carrying the explicit guarantees of central governments, central banks, international organisations, multilateral development banks or public sector entities, where unsecured claims on the entity providing the guarantee would be assigned a 0 % risk weight under Articles 78 to 83;

(d) other exposures attributable to, or guaranteed by, central governments, central banks, international organisations, multilateral development banks or public sector entities, where unsecured claims on the entity to which the exposure is attributable or by which it is guaranteed would be assigned a 0 % risk weight under Articles 78 to 83;

~~(e) asset items constituting claims on and other exposures to central governments or central banks not mentioned in point (a) which are denominated and, where applicable, funded in the national currencies of the borrowers;~~ asset items constituting claims on Member States' regional governments and local authorities where those claims would be assigned a 0 % risk weight under Article 78 to 83 and to other exposures to or guaranteed by such governments and authorities claims on which would be assigned a 0 % risk weight under Articles 78 to 83;

(g) asset items and other exposures secured, to the satisfaction of the competent authorities, by collateral in the form of cash deposits placed with the lending credit institution or with a credit institution which is the parent undertaking or a subsidiary of the lending institution; and

(h) asset items and other exposures secured, to the satisfaction of the competent authorities, by collateral in the form of certificates of deposit issued by the lending credit institution or by a credit institution which is the parent undertaking or a subsidiary of the lending credit institution and lodged with either of them;

2. Member States may fully or partially exempt from the application of Article 111(1):

(a) covered bonds falling within the terms of Annex VI, Part 1, points 68 to 70;

(b) exposures to counterparties referred to in Article 80(7) or 80(8). For this purpose, point (d) of Article 80(7) shall not be applied. Exposures that do not meet these criteria, whether exempted from Article 111(1) or not, shall be treated as exposures to a third party.

## **Supervisory arrangements**

### *Article 4, paragraphs 48 and 49*

(48) 'Systemically relevant branch' means a branch of a credit institution that has been designated as such by the competent authorities under Article 42(2).

(49) 'consolidating supervisor' means the competent authority responsible for the exercise of supervision on a consolidated basis of EU parent credit institutions and credit institutions controlled by EU parent financial holding companies.

### *Article 40*

1. The prudential supervision of a credit institution, including that of the activities it carries on in accordance with Articles 23 and 24, shall be the responsibility of the competent authorities of the home Member State, without prejudice to those provisions of this Directive which give responsibility to the competent authorities of the host Member State.

2. Paragraph 1 shall not prevent supervision on a consolidated basis pursuant to this Directive.

### *Article 42*

1. The competent authorities of the Member States concerned shall collaborate closely in order to supervise the activities of credit institutions operating, in particular through a branch, in one or more Member States other than that in which their head offices are situated. They shall supply one another with all information concerning the management and ownership of such credit institutions that is likely to facilitate their supervision and the examination of the conditions for their authorisation, and all information likely to facilitate the monitoring of such institutions, in particular with regard to liquidity, solvency, deposit guarantees, the limiting of large exposures, administrative and accounting procedures and internal control mechanisms.

2. If the competent authority of the host Member State is of the view that a branch of a credit institution should be designated as systemically relevant according to the criteria set out in subparagraph 3, it shall notify the competent authority of the home Member State.

The competent authorities of the home and the host Member State, and the consolidating supervisor where Article 129(1) applies, shall do everything within their power to reach a joint determination on the designation of branches as being systemically relevant.

The branch is deemed systemically relevant in view of its market share in the host Member State, the likely impact of a suspension or closure of the credit institution's operations on the payment and clearing and settlement system in the host Member State, or any other considerations pertaining to the size and importance of the branch in relation to the host Member State's banking or financial system. If the market share of a branch of a credit institution in terms of deposits exceeds [X%] in the host Member State, its systemic relevance must be assessed.

In the absence of a joint determination, three months following the notification referred to in the first subparagraph, the competent authority of the host Member State shall make its own decision. In making its decision, it shall duly take into account any views and reservations of the competent authorities concerned.

The decisions referred to in the second and fourth subparagraph shall be set out in a document containing the fully reasoned decision, transmitted to the competent authorities concerned, recognised as determinative and applied by the competent authorities in the Member States concerned.

The designation of a branch as being systemically relevant shall not affect the rights and responsibilities of the competent authorities under this Directive with the exception of Article 42(3).

3. The competent authorities of the home Member State shall communicate to the competent authorities of a host Member State where a systemically relevant branch is established the information referred to in Article 132(1)(c) and (d) and carry out the tasks referred to in Article 129(1)(c) in cooperation with the competent authorities of the host Member State.

If a competent authority of a home Member State becomes aware of an emergency situation within a credit institution as referred to in Article 130(1), it shall alert and communicate as soon as is practicable with the authorities referred to in the last subparagraph of Article 49 and in Article 50 as set out in Article 130(1).

4. Where Article 129(3) does not apply, the competent authority of the home Member State supervising a credit institution with systemically relevant branches in other Member States shall establish and chair a college of supervisors to facilitate the cooperation under Articles 42(1) and 42(3). The competent authorities of the home and the host Member States shall have written coordination and cooperation arrangements in place. The establishment of colleges shall not affect the rights and responsibilities of the competent authorities under this Directive.

#### *Article 49*

This Section shall not prevent a competent authority from transmitting information to the following for the purposes of their tasks:

- (a) central banks and other bodies with a similar function in their capacity as monetary authorities; and
- (b) where appropriate, to other public authorities responsible for overseeing payment systems.

This Section shall not prevent such authorities or bodies from communicating to the competent authorities such information as they may need for the purposes of Article 45.

Information received in this context shall be subject to the conditions of professional secrecy specified in Article 44(1).

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 their respective statutory tasks, including the

conduct of monetary policy, the oversight of payments and securities settlement systems, and the safeguarding of financial stability.

#### *Article 50*

Notwithstanding Articles 44(1) and 45, the Member States may, by virtue of provisions laid down by law, authorise the disclosure of certain information to other departments of their central government administrations responsible for legislation on the supervision of credit institutions, financial institutions, investment services and insurance companies and to inspectors acting on behalf of those departments.

However such disclosures may be made only where necessary for reasons of prudential control.

In an emergency situation as referred to in Article 130(1), Member States shall allow competent authorities to disclose information to the departments referred to in the first subparagraph in all Member States concerned.

#### *Article 129*

1. In addition to the obligations imposed by the provisions of this Directive, the competent authority responsible for the exercise of supervision on a consolidated basis of EU parent credit institutions and credit institutions controlled by EU parent financial holding companies shall carry out the following tasks:

(a) coordination of the gathering and dissemination of relevant or essential information in going concern and emergency situations;

(b) planning and coordination of supervisory activities in going concern ~~as well as in emergency situations~~, including in relation to the activities referred to in Articles 123, 124 and points 14 and 15 of Annex V, part 10, in cooperation with the competent authorities involved; and

(c) planning and coordination of supervisory activities in cooperation with the competent authorities involved, and if necessary with central banks, in preparation of and during emergency situations, including adverse developments in credit institutions or in financial markets. This includes exceptional measures referred to in Article 132(3)(b), the preparation of joint assessments, the implementation of contingency plans and communication to the public.

2. In the case of applications for the permissions referred to in Articles 84(1), 87(9) and 105 and in Annex III, Part 6, respectively, submitted by an EU parent credit institution and its subsidiaries, or jointly by the subsidiaries of an EU parent financial holding company, the competent authorities shall work together, in full consultation, to decide whether or not to grant the permission sought and to determine the terms and conditions, if any, to which such permission should be subject.

An application as referred to in the first subparagraph shall be submitted only to the competent authority referred to in paragraph 1.

The competent authorities shall do everything within their power to reach a joint determination on the application within six months. This joint determination shall be set out in

a document containing the fully reasoned decision which shall be provided to the applicant by the competent authority referred to in paragraph 1.

The period referred to in subparagraph 3 shall begin on the date of receipt of the complete application by the competent authority referred to in paragraph 1. The competent authority referred to in paragraph 1 shall forward the complete application to the other competent authorities without delay.

In the absence of a joint determination between the competent authorities ~~within 6 months~~ within the periods referred to in the third and fifth subparagraphs, the competent authority referred to in paragraph 1 shall make its own decision on the application. The decision shall be set out in a document containing the fully reasoned decision and shall take into account the views and reservations of the other competent authorities expressed during the periods referred to in the third and fifth subparagraphs. The decision shall be provided to the applicant and the other competent authorities by the competent authority referred to in paragraph 1.

The decisions referred to in the third and ~~sixth-fifth~~ subparagraphs shall be recognised as determinative and applied by the competent authorities in the Member States concerned.

3. The consolidating supervisor shall establish college of supervisors to facilitate the exercise of its tasks referred to in the first and second paragraph and in Article 130. The establishment and functioning of colleges shall be based on the written arrangements referred to in Article 131. The Committee of European Banking Supervisors shall elaborate guidelines for the operational functioning of the college.

The 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 shall be members of the college. The consolidating supervisor shall chair the meetings of the college. The members of the college shall agree on the allocation of tasks.

For these purposes the consolidating supervisor may set up standing or ad hoc groups of members of the college taking into account the relevance of the supervisory activity to be planned or coordinated for those authorities and the obligations referred to in Articles 40(3) and 42(3).

These groups shall be provided with a clear mandate by the consolidating supervisor and report regularly to the college. All members of the college shall be informed of the creation of ad hoc or standing groups and their mandates.

The activities of the colleges shall be without prejudice to the powers conferred upon competent authorities elsewhere in this directive.

The consolidating supervisor shall regularly inform the Committee of European Banking Supervisors of the activities of the college of supervisors, including in emergency situations.

#### *Article 130*

1. Where an emergency situation, including adverse developments in financial markets, arises ~~within a banking group~~, which potentially jeopardises the stability of the financial system in any of the Member States where entities of a group have been authorised or where systemically relevant branches are established, the competent authority responsible for the exercise of supervision on a consolidated basis shall, ~~as soon as is practicable~~ subject to Chapter 1, Section 2, alert as soon as is practicable, the authorities referred to in the last

subparagraph of Article 49(a) and in Article 50, and shall communicate all information that is essential for the pursuance of their tasks.

These obligations shall apply to all competent authorities under Articles 125 and 126 in relation to a particular group, and to the competent authority identified under Article 129(1).

If the authority referred to in the last subparagraph of Article 49 becomes aware of a situation described in the first subparagraph, it shall alert as soon as is practicable the competent authorities identified in Articles 125 and 126.

Where possible, the competent authority and the authority referred to in the last subparagraph of Article 49 shall use existing defined channels of communication."

*Changes to Directive 2006/49/EC*

*Article 38, paragraph 3*

3. Articles 42(2), with the exception of its third subparagraph, and Article 42(3) of Directive 2006/48/EC shall apply mutatis mutandis to the supervision of investment firms that do not fulfil the criteria set out in Article 20(2) or 20(3) or the first subparagraph of Article 46.