17 October 2008

CEBS's technical advice to the European Commission on options and national discretions

Executive summary

1. This advice sets out CEBS's views on the issues called for in the European Commission's (the 'Commission') Call for Advice No.10 on options and national discretions in the Capital Requirements Directive (the 'CRD').

2. As specified by the Commission, the scope of CEBS's work includes the 101 options and national discretions identified in CEBS's supervisory disclosure framework (SD), as well as the mutual recognition clauses (separately identified in the supervisory disclosure framework) and the corresponding national discretions. A number of other potential discretions were identified by the industry in their responses to CEBS's public questionnaire of July 2007.

3. CEBS started its technical work with a thorough analysis of the responses to the questionnaire to determine the importance of each option and national discretion for its Members and market participants. CEBS also conducted a high level Impact Assessment including a qualitative cost/benefit analysis of the national discretions to help in the formulation of the draft proposals put forward for the public consultation that ended on 15 August 2008. The consultation paper (CP 18) reflected both the analysis of the responses to the questionnaire and the preliminary reasoning which built on the Impact Assessment.

4. Twenty responses were received to the public consultation, mostly from trade associations. In general, respondents supported CEBS's approach and agreed that the proposals outlined in the consultation paper were going in the right direction. Respondents welcomed the reduction in the number of options and national discretions in the CRD as a way of creating more supervisory convergence in the EU, of ensuring a consistent approach to Pillars 2 and 3 and of reducing distortions to competition and the administrative burden. A number of respondents considered that CEBS should have gone further in its proposals, i.e. by further reducing options and national discretions. However, a number of the respondents stressed that there are also some cases where the existence of local market conditions or legislative specificities justify the adoption of different approaches so that certain options and national discretions should be maintained.

5. CEBS's Consultative Panel nominated industry experts to be part of a complementary mirror working group on options and national discretions which met on a regular basis with CEBS. The discussions between CEBS and the industry experts were helpful given the scale and nature of the challenge. They also brought more clarity to the issues surrounding national discretions and helped find solutions for potentially different interests within the industry. The involvement of the industry at an early stage of CEBS's work was greatly appreciated by respondents to the public consultation.

6. As a result of its work, and after having carefully considered the feedback received in the public consultation, CEBS is presenting its response to the Commission's Call for Advice. For approximately 72% of the 152 discretions CEBS is proposing real solutions that it believes can bring about further harmonization of supervisory practices and levelling of the playing field among institutions.

7. CEBS is also proposing to keep as a national discretion approximately 28% of the 152 provisions covered in its analysis, albeit where possible with accompanying proposals to alleviate any negative side-effects of those national discretions (e.g. by introducing binding mutual recognition clauses). In any event, it should be noted that approximately one third of these national discretions (approximately 8% of the total) will expire within a relatively short period. CEBS is therefore confident that approximately 80% of the discretions analysed will disappear in the near future if its Advice is taken on board by the European Commission.

8. CEBS believes its proposals strike the right balance between the prudential concerns of its Members, the flexibility supervisors need to perform their duties and the interests of both domestic institutions and those that operate cross-border.

Background

9. In May 2007 the Commission issued a Call for Technical Advice (No. 10) on options and national discretions in the Capital Requirements Directive (the 'CRD').[1]

10. CEBS was asked to conduct a technical analysis of the exercise of options and discretions identified in CEBS's supervisory disclosure framework by indicating for each of them: i) the manner of exercise; ii) whether CEBS deems it appropriate, with a view to achieving convergence of supervisory practices, to seek further harmonisation; iii) where consensus cannot be found on the deletion of an option or discretion, or on the use of mutual recognition, the precise reason for this, including the views expressed by the majority and the minority of its Members; and iv) where appropriate, drafting proposals.

11. In performing this work, the Call for Advice suggests that CEBS classifies the options and national discretions into the following categories: i) options and discretions that might be subject to mutual recognition along the lines set out in the Annex to the Call for Advice; ii) possible legitimate options and discretions; and iii) options and discretions which should be deleted.

12. The Call for Advice indicates that on-going consultation with the industry should play a key role in providing insights into ways of dealing with the reduction in the number of national discretions. CEBS has also endorsed and stressed the importance of dialogue with the industry.

13. **This advice sets out CEBS's response to the Commission's Call for Advice on options and national discretions in the CRD.**

Methodology

On-going consultation with market participants and supervisors

14. In the summer of 2007, CEBS developed a questionnaire on the options and national discretions in the CRD and on possible routes for their reduction. Members, observers and market participants worked together on the drafting of the questionnaire.

15. In July 2007, the questionnaire, inviting market participants to provide input to CEBS was posted on the website for a three-month response period that ended on 19 October 2007[2]. In parallel, a similar questionnaire was sent to CEBS's Members and Observers.

16. Answers were received from all the supervisors represented in CEBS and from 16 market participants (13 from trade associations and 3 from

[1] The Commission's call for advice is published on CEBS public website under: http://www.c-ebs.org/formupload/d4/d4c28ab4-8011-4d53-a09c-d3853899e119.pdf

[2] The public questionnaire is published on CEBS public website under: http://www.c-ebs.org/formupload/09/09e6edbc-9835-467b-8af3-fe1670bfb462.xls .

individual institutions)[3]. Some of the industry responses focused only on those areas of the national discretions which had been identified as having a special interest for them. These provided an important input to the Impact Assessment performed by CEBS, as set out below.

17. CEBS started its technical work with a thorough analysis of the responses to its questionnaire in order to determine the importance of each option and national discretion for its Members and market participants. CEBS also focused its efforts on gaining more insight into the reasoning behind each of the discretions in order to better assess the best way forward.

18. At the end of 2007, a CEBS working group was set up and Members and Observers from the Consultative Panel were invited to nominate industry experts to be part of a complementary (mirror) working group on options and national discretions. CEBS's working group met on a monthly basis and also twice with the mirror industry working group (in addition to teleconferences).

19. The discussions between the CEBS working group and the industry experts were open, transparent, non-binding and successful in bringing more clarity to the issues surrounding national discretions.

20. As a result of its work, CEBS published its preliminary proposals in May 2008 for a public consultation that ended on 15 August 2008.[4]

21. Twenty responses were received to the public consultation, mostly from trade associations.[5] In general, respondents supported CEBS's approach and agreed that the proposals outlined in the consultation paper were steps in the right direction. Respondents welcomed the reduction in the number of options and national discretions in the CRD as a way of creating more supervisory convergence in the EU, of ensuring a consistent approach to Pillars 2 and 3 and of reducing distortions to competition and the administrative burden. A number of respondents considered that CEBS should have gone further in its proposals by further reducing options and national discretions. However, a number of the respondents stressed that there are also some cases where the existence of local market conditions or legislative specificities justify the adoption of different approaches so that certain options and national discretions should be maintained.

22. The transparency provided on the reasoning behind the proposals and the glossary of terms was welcomed as it helped bring about a better understanding of the benefits and downsides of the solutions considered and the way forward proposed by CEBS.

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[3] Industry's responses are published on CEBS public website under: http://www.c-ebs.org/getdoc/993cfffc-e59d-4696-944e-ea7a0d5065f6/Responses-to-questionnaire-on-Options-and-National.aspx

[4] CEBS's consultation paper CP 18 is published on CEBS public website under: http://www.c-ebs.org/formupload/09/09b21b4b-cca2-4885-964a-2a1e6db3df78.pdf

[5] Responses to CP18 are published on CEBS public website under: http://www.c-ebs.org/getdoc/d2d67619-40ac-44b4-9dfa-c3cb94594f05/Responses-to-CP08.aspx

23. CEBS has published a feedback document presenting the key points arising from the consultation, a summary of all the public responses and CEBS's detailed views on these comments, as well as the changes made to address them.[6]

Scope of the work

24. As specified by the Commission, the scope of CEBS's work includes the 101 options and national discretions identified in CEBS's supervisory disclosure framework, as well as the mutual recognition clauses (separately identified in the supervisory disclosure framework) and their corresponding national discretions. A number of other potential discretions were identified by the industry in their responses to CEBS's questionnaire.

25. CEBS understands that '**Options and National discretions**'[7] can be interpreted broadly or narrowly. The narrow definition limits 'options and national discretions' to those provisions in the CRD which allow for a Member State or its competent authorities i) to choose how all relevant institutions in the jurisdiction should comply with a given provision, selecting from a range of alternatives set out in the Directive; and ii) to choose whether or not to apply a given provision to all institutions in the jurisdiction. In these cases, the level-playing field between institutions can be impacted, and for institutions and banking groups operating cross-border this can lead to additional burdens to accommodate the different approaches in each of the Member States in which they operate. Where the proposals set out in the Annex refer to national discretions, this limited definition is referred to.

26. However, for the purpose of determining the scope of the work, CEBS has also taken on board the suggestions put forward by market participants in their responses to CEBS's questionnaire. This means that, in practice, a broader pragmatic approach was taken to the meaning of 'options and national discretions'. In addition to each of the provisions identified in the supervisory disclosure framework and the provisions with a mutual recognition clause attached, a number of other provisions were put forward by industry respondents as part of the new texts in the CRD which were capable of being applied, in the view of the industry participants, as an option or national discretion in some or all of the Member States. These provisions were included as part of the work regardless of the opinion of CEBS's Members and of the outcome of the subsequent analysis. This allowed for a full review of all provisions where the issue of national discretion might play a role, even if only to clarify that it does not or should not.

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[6] CEBS's feedback statemement on the public responses to CP18 is publish on CEBS public website under: http://www.c-ebs.org/getdoc/22d34e3f-9039-4530-908d-1d25a0993026/2008-17-10-Final-feedback-document-on-CP18.aspx

[7] The current work on options and national discretions will have implications for what needs to be disclosed by members under the CEBS's supervisory disclosure framework. This issue will need to be addressed subsequently.

High level considerations

27. A number of high level considerations were developed by CEBS to help frame and guide the discussion on possible solutions for individual options and national discretions:

    a) The existing degree of convergence in the exercise of the options and national discretions by Member States is an important parameter, but not in itself a determining factor for deciding the way forward in relation to a national discretion; there may be justifiable grounds for applying a national discretion in a different manner.

    b) The decision on options and national discretions should take into account as much as possible both cross-border and domestic aspects, i.e. the interests of domestically focussed institutions should not be down played when the interests of cross border institutions are considered and vice-versa.

    c) The treatment (keeping, deleting the provision, deleting the discretion or transforming it into an option for institutions) of options and national discretions should be subject to a high level impact assessment, including a qualitative cost/benefit analysis. Consideration should also be given to the need for legal continuity for important businesses and the possible use of a transitional period or a grandfathering clause if this would allow a gradual adjustment of the business.

    d) In general, the discretionary part of options and national discretions could be deleted if the fulfilment of a set of criteria to be applied by the credit institutions/investment firms is satisfactorily defined in the CRD. The more lenient approach allowed would then be open for the institutions, subject to them remaining within the boundaries set by the criteria.

    e) Where appropriate, the national discretion can be replaced with a joint/common assessment process to be carried out by all supervisors that wish to participate, similar to the current practice in the recognition of ECAIs.

    f) Solutions using the option that is most risk sensitive and proportionate are preferred.

    g) The possibility of removing options and national discretions rooted in local market conditions should also be examined, e.g. by looking at the possibility of achieving the same purpose by applying an existing proportionality provision. Binding mutual recognition should be taken into consideration as a possible solution for achieving a level playing field across institutions active in a Member State or between Member States.

    h) In areas where competent authorities and the industry have insufficient experience, options and national discretions should be kept for the time being, subject to a review clause. Where it is not expected they will acquire the experience due to the lack of relevance of the provision in practice, it should be deleted from the CRD.

Glossary

28. For the purpose of the present report, the findings on how to deal with the various options and discretions have the following meanings:

a) 'Keep as national discretion' – refers to a discretion (given to Member States or competent authorities) that should be kept in its current form for one of the following reasons:

i) the provision can only be changed as part of a future general overhaul of the subject matter (such as the scope of application and definition of capital);

ii) the provision of which the national discretion is part will expire (as a transitional or grandfathering provision) before or by the end of 2011, which means that any change in the text of the CRD would have no or very limited validity by the time the provision would have been amended through the legislative process;

iii) the provision is a genuine reflection of local market specificities and national laws other than the banking supervision laws; and

iv) further work on the provision is hampered by the lack of practical experience and/or the lack of satisfactory common criteria at this point in time, or there are no other viable alternatives to keeping it.

b) 'Mutual recognition' – refers to a situation in which Member States are allowed or, in some cases, obliged to recognize the decision taken by another Member State if their institution wants to use it in its business.

i) Where **binding mutual recognition** is explicitly mentioned, the solution offered would require each Member State and its competent authorities to allow their institutions to use the judgement or opinion of another Member State or competent authority on (a) issues which exclusively relate to features of the local market and (b) issues which relate to local laws outside the scope of banking supervision, such as company law, bankruptcy law, contract law and securities law.

ii) **Non-binding mutual recognition** is offered as a default option where there may be relevant information not available to the other competent authorities, or where the judgement on a market or individual entity relates to markets in various jurisdictions inside or outside of the EU. In this case, each Member State and its competent authorities could allow their institutions to use the judgement or opinion of another Member State or competent authority.

c) 'Keep as or transform into a supervisory decision'[8] – refers to a provision that should be implemented by all Member States and be applied on a case by case basis by their competent authorities and not (either by the Member State or the authority) to all institutions in the relevant jurisdiction. In particular, when the Directives refer to the need for an institution to obtain a competent authority's approval or authorisation for various purposes, such authorisation or approval may be discretionary, but if the decision is made on an individual basis relating to the specific circumstances of the entity involved it does not constitute a national discretion. There are two sub-types of supervisory decisions:

i) where there is judgement by the supervisor but no choice (i.e. if in its judgement the criteria are fulfilled, the supervisor has to agree with the choice of the credit institution or investment firm); and

ii) where there is judgement and choice by the supervisor (i.e. if it thinks the criteria set are fulfilled but there is also a subjective choice by the supervisor as to whether the application is a good idea in this specific case).

Both of the sub-types can arise in the context of a supervisory approval process (e.g. IRB) that competent authorities conduct on a case by case basis.

d) 'Transform into a general rule' – this potential solution was referred to in CEBS's questionnaire to the industry and CEBS's Members. However, it often overlaps either with the 'option for credit institutions' or with the 'deletion of the discretionary part of the provision', both of which are described below. As a result, in this Advice, 'transform into a general rule' is no longer used as a proposed solution.

e) 'Delete or remove an option or a national discretion' – refers to a situation in which either: i) only one of the options is maintained and it is, therefore, transformed into a mandatory provision to be applied by all credit institutions or by all Member States; ii) the exercise of a given discretion becomes mandatory on all Member States or competent authorities; or iii) the provision will be completely deleted from the CRD. The deletion can happen immediately or after a transitional period.

f) 'Option for credit institutions or investment firms' – refers to the following types of situations in which:

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[8] CEBS acknowledges that there a number of issues to take into consideration regarding its proposal for the implementation of the "supervisory decisions" by all Member Sates:

i) The effective distribution of powers in the Member States is distinct: in some jurisdictions the competent authority needs a specific legal provision to have the power to exercise a discretion; in other jurisdictions the competent authorities have been granted wider regulatory powers and there is no need formally to implement the discretion in the law;

ii) Given the national legal environment (outside of banking supervision laws) the conditions set in some of the discretions can never be satisfactorily fulfilled, in which case the Member States would not need to implement a specific "supervisory decision".

i) the credit institution or investment firm can choose between the two different options set out in the Directive;

ii) the credit institution or the investment firm is explicitly given the choice whether or not to apply the provision; or

iii) the credit institution or the investment firm is implicitly given the choice to make use of e.g. a mutual recognition clause (i.e. allowing it, but not forcing it, to use a more lenient risk weighting due to local market circumstances).

g) 'Joint assessment process' – refers to the sharing of information and expertise, as well as jointly investigating and/or interviewing relevant parties, aimed at reaching a common understanding of the facts as well as, where possible, reaching a consensus on the outcome of the analysis. The consensus view is not binding but forms a strong basis upon which, coherently with their national legal framework, competent authorities/Member States will take their decisions in each jurisdiction. Depending on the subject matter, there are two categories of joint assessment process:

i) a joint assessment process based on the application of an individual third party (e.g. ECAI), where all supervisors to whom a similar application has been made are invited to participate, on a voluntary basis, in the process (the limitation is due, amongst other factors, to privacy reasons, see the ECAI process as agreed and published by CEBS on GL07).

ii) a joint/common assessment process regarding a legal system or general occurrence (e.g. equivalence of third country supervisory and regulatory arrangements), where all supervisors in the EU are invited and all interested supervisors can share information and participate in the work on a voluntary basis. The outcome of the common/joint process forms a strong basis on which competent authorities will take the decisions in their jurisdictions.

h) 'Grandfathering' - refers to provisions that allow an old rule to continue to apply to certain existing situations, whereas a new rule will apply to all future situations[9].

i) 'Transitional provision' - refers to provisions in an instrument of law designed to ensure a smooth transition from the old legal regime to the new legal regime[10].

[9] Applied to capital instruments that means that instruments issued under a previous legal regime may continue to be used, but may not be issued any more.

[10] Article 152 of the CRD provides examples of the different forms that such provisions can take, e.g. by providing capital floors calculated with reference to Directive 2002/12 for a limited period of time or by granting limited derogations from CRD requirements.

Summary of CEBS's proposals

29. Keeping in mind the objectives of this exercise – the reduction of options and national discretions in the CRD in order to further harmonize supervisory practices - CEBS used the high level considerations it had developed and qualitative cost/benefit analysis to formulate its proposals.

30. As a result, and after having carefully considered the feedback received in the public consultation, CEBS is proposing to keep as a national discretion around 28% of the 152 provisions covered in its analysis, where possible with accompanying proposals to alleviate any negative side effects of those national discretions (e.g. by introducing binding mutual recognition). In any event, it should be noted that approximately one third of those national discretions (around 8% of the total) will expire within a relatively short period.

31. For the other discretions, which form the large majority (approximately 72% of the 152 provisions), CEBS is proposing solutions that it believes can ensure further harmonization of supervisory practices and the enhancement of the level playing field among institutions. Of these, CEBS is proposing for approximately one third (around 23% of the total) to keep them as, or to transform them into, a supervisory decision to be implemented and applied on a case by case basis. In CEBS's view, this solution should reduce the costs associated to the existence of national discretions for groups with cross-border activities, for example in the context of the approval of internal models.

32. CEBS is confident that around 80% of the provisions analysed will disappear in the near future. CEBS believes its proposals strike the right balance between the prudential concerns of its Members, the flexibility supervisors need to perform their duties and the interests of domestic and cross-border institutions. See the table below for an overview of the discretions which should be kept, and for the rationale behind this, as well as for an overview of the various other solutions offered. A separate table sets out the alleviating measures proposed for the national discretions which are to be kept.

33. If, as a result of CEBS's Advice, the CRD is amended, CEBS will update its supervisory disclosure framework accordingly. Meanwhile, CEBS is continuing its efforts to upgrade and clarify the information available in the framework across jurisdictions through a continuous dialogue with its Members.

34. Please see the **Annex** for a comprehensive overview of the analysis and advice for each option and/or national discretion. To give a general idea of the direction the work of CEBS has taken, an overview of the proposals made is contained in the following table.

CEBS's Proposals		Number of the specific national discretion[11]	Total
Options and discretions which should be kept in their current form	i) because the provision can only be changed as part of a future general overhaul of the subject matter	4, 5, 6, 9, 10	5
	ii) the provision will be deleted in a short period through the expiry of its validity	68, 69, 70, 71, 72, 73, 74, 75, 78, 79, 80, 151, 152	13
	iii) because the provision is rooted in features of a local market and national laws other than the banking supervision laws	49, 50, 51, 136, 138, 140, 142	7
	iv) due to the lack of practical experience and/or the lack of satisfactory common criteria, or in response to industry's feedback, or for the lack of other viable alternatives to keeping it	15, 19, 31, 32, 34, 39, 41, 42, 45, 55, 67, 81, 82, 102, 104, 110, 112, 113	18
Options and discretions which should be kept as or transformed into a supervisory decision to be used on a case by case basis	i) where there is judgement by the supervisor, but no choice	20, 21, 23, 24	4
	ii) where there is judgement and choice by the supervisor	2, 3, 8, 11, 12, 13, 14, 22, 25, 26, 27, 64, 77, 83, 84, 93, 95, 125, 126, 127, 129, 139	22
	iii) as part of the overall approval process	16, 17, 37, 38, 46, 61,62, 63, 115, 144	10
Options and discretions which should be deleted or	i) the redrafted provision becomes a rule	18, 28, 48, 58, 66, 94, 97, 124	8
	ii) the provision is completely	30, 33, 35, 43, 44, 57, 85, 86, 87, 88,	18

[11] "Number" refers to the order given to each national discretion in turn in the Annex simply for the purposes of a consistent, short-hand way of referring to a particular discretion.

removed	deleted from CRD	89, 90, 91, 98, 99, 100, 109, 141	
Options and discretions which should be kept or transformed into an option for credit institutions or investment firms		1, 7, 14, 29, 36, 40, 47, 52, 53, 54, 56, 59, 60, 65, 76, 81, 92, 95, 96, 101, 106, 107, 108, 128, 137, 141, 143	27
Provisions that are mutual recognition clauses (either binding or non-binding)		103, 105, 111, 114, 116, 132, 145, 148, 149, 150	10
Out of scope		117, 118, 119, 120, 121, 122, 123, 130, 131, 133, 134, 135, 146, 147	14

Note: National discretions numbers 14, 81, 95 and 141 are classified under two different categories because they include two provisions and different treatments are proposed.

35. For most of the options and national discretions CEBS is proposing to keep, there is a lack of practical experience and more time is needed to allow institutions and supervisors to gain the necessary experience in order to assess the need for keeping the national discretion (e.g. IRB). CEBS is also proposing to keep other national discretions because they relate to a subject which is under review in other *fora* and can only be dealt with in that wider context (e.g. definition of capital), or because they will expire within a relatively short time. CEBS also believes that a number of the remaining national discretions which are to be kept could potentially be removed from the CRD if good quality criteria are developed and reliance is placed on the supervisor to assess whether the criteria are fulfilled.

36. To alleviate the potential side-effects of keeping some discretions and to promote the convergence of practices, CEBS also proposes the following:

Options and discretions which should be subject to mutual recognition	i) binding mutual recognition	25, 26, 31, 39, 41, 45, 50, 68, 102, 104, 110	11
	ii) non-binding mutual recognition	23, 24, 27, 49, 51, 83, 132, 145, 148, 149, 150	11
Options and discretions in which an EU Joint assessment process should be considered		23, 24, 27, 83, 130, 131, 145, 148, 149	9

Summary of findings from the Impact Assessment

37. CEBS has been asked to develop its advice to the Commission in a manner consistent with the 'better regulation agenda'. This was achieved by following, as far as time constraints allowed, the draft impact assessment (IA) guidelines that have been developed by the 3L3 Committees[12], which have since been finalized and published in April 2008.

38. IA advice was sought from CEBS Members outside the expert group. Furthermore, various panels of stakeholder groups that assist CEBS, both competent authorities and the above mentioned industry experts, were invited to comment on CEBS's proposals during the assessment process.

39. The IA helped CEBS describe and explain the decision making process and to identify policies that should be implemented. The underlying analysis was prepared as a basis for discussion at CEBS.

40. CEBS adopted a 'fit for purpose' approach to the IA. Given time constraints and the scale of the exercise, this meant focusing on a qualitative high level analysis for each of the 152 national discretions under review. The industry expressed its support for the qualitative IA.

41. In general, the provisions were far from being homogeneous, but some options and national discretions could be grouped and treated in the same way.

Step 1: Problem Identification

42. According to the 3L3 IA guidelines, the first step was to identify the problem and the threat it poses to regulatory objectives. CEBS has considered the nature of the problem that each discretion had been introduced to solve. In particular, it was necessary to establish whether or not the discretions were addressing relevant market or regulatory failures. This required answers to the following questions:

    - what problem was the discretion seeking to address;
    - was there any evidence to suggest that the problem was material; and
    - what was the likelihood of a market-based solution to the problem in the short-to-medium term?

43. Of the 152 discretions assessed a few were found not to be addressing relevant market failures. Such discretions could not reasonably be retained on economic grounds because keeping them would provide no benefits and impose only costs. As a result, the proposal on these discretions is to remove them from the CRD.

[12] 'Impact Assessment Guidelines for EU Lamfalussy Level 3 Committees' May 2007, since finalized and published in April 2008 on CEBS public website under: http://www.c-ebs.org/formupload/30/305f9126-d16e-473e-a843-5733e67687d0.pdf

Step 2: Development of main policy options:

44. Of the vast majority of discretions where the analysis suggested that they were addressing a relevant market failure, a reasonable number of policy options were considered in order to ensure that the most appropriate proposal was chosen. The main policy options under consideration were:

    - keep the discretion in its present form;
    - remove the discretion completely from the CRD;
    - delete the discretionary part of the provision;
    - transform the discretion into an option for credit institutions/investment firms; and
    - consider a mutual recognition clause and/or a joint recognition process.

Step 3: Definition of broad policy objectives:

45. In addition to the development of sensible policy options, the regulatory objectives of each discretion were identified in order to have a clear view of the effects of the different policy options under consideration.

Step 4: Assessment of likely costs and benefits of each policy option:

46. In order to assess the likely positive and negative effects, as well as the net effect of the policy options, a high level cost/benefit analyis (CBA) was used. The status quo was considered as the baseline against which the analysis took place (i.e. possible costs and benefits of the most likely policy options were assessed against the current situation where the national discretion is in place). In its CBA, CEBS took into account the materiality of the identified costs/benefits.

47. In considering the impacts of these discretions it was necessary to take into account:

    - the direct costs/benefits to supervisors, compliance costs/benefits to regulated entities, and, just as importantly, the indirect costs/benefits to the market;
    - whether the costs and benefits identified were likely to be distributed differently by firm type or firm size; and
    - whether the costs and benefits of each discretion were independent of each other or whether there were any important interdependencies to be considered.

Step 5: Comparison of options and identification of a preferred policy option:

48. The result of the high level CBA after comparison of the different policy options was the identification of a preferred policy option. These are summarised in the following paragraphs.

49. Of the discretions determined to be addressing a relevant market failure, the high level CBA indicated that for approximately one sixth of them there was a reasonable expectation of net costs from removing the discretion and therefore a reasonably clear case for them to be retained. The main drivers behind this were strong expectations, or evidence, that firms would manage their activities with a higher sensitivity to risk, which reduces the probability of default and leads to fewer bank failures.

50. In the case of slightly less than one third of all assessed discretions, the high level CBA - or the feedback from respondents in the absence of a clear CBA - suggested a reasonable expectation of net benefits from changing the discretion, therefore indicating a case for removing it entirely from the CRD, deleting the discretionary part of the provision, or transforming into an option for the institutions. In these cases, material costs could be identified but larger benefits were anticipated through giving incentives for market development and integration. This promotion of convergence is likely to lead to increased competition. The potential for industry to incur costs in making systems changes was also a consideration with some of the proposals that provide for an option for credit institutions or investment firms as opposed to those requiring a particular treatment that might appear more favourable in terms of, say, the amount of regulatory capital.

51. In cases where the result of the CBA was ambiguous, or uncertain, further challenge was undertaken with the emphasis being on the need to justify retention of the option/national discretion. Uncertain CBA outcomes were due to the lack of evidence on the materiality of the discretions' effects, disagreement on the substance or major impact differences between Member States.

Step 6: Consultation on the draft policy proposal:

52. CEBS organised its consultation processes in line with its Public Statement of Consultation Practices. On some discretions, specific input from all stakeholders was requested during the consultation period. The input received from the public consultation helped clarify the choices to be made by CEBS.

Step 7: Publication of the responses and the feedback statement:

53. In addition to the twenty responses received, a feedback statement was made public summarizing the main public comments received and explaining the reasons for modifications to the policy proposals as a result of the comments received. All responses have been published on CEBS's public website, with the exception of two, as requested by these respondents. In one of these cases, the comment received overlapped with comments of other respondents; in the other case the issue raised was outside the scope of the national discretions exercise, and proposed future work for CEBS in another area (which will – like all suggestions - be given due consideration by CEBS).

Step 8: Review of the policy:

54. This last step is not applicable in this case.

55. The following template was used by CEBS to carry out the high level IA for each option/national discretion.

1. Identification of the problem	
1.1. What problem is the discretion seeking to address? Is there any evidence to suggest the problem is material?	
1.2. What is the likelihood of there being a market-based solution to the problem?	
2.Cost/Benefit Analysis (CBA) on the solution(s) considered by CEBS versus keeping it (baseline: status quo)	
2.1. Costs	2.2. Benefits
a. Identification of costs: direct costs to supervisors, compliance costs to regulated entities, indirect costs to the market?	b. Identification of benefits: direct benefits to supervisors, compliance benefits to regulated entities, indirect benefits to the market?
c. Distribution of costs: distributed differently by firm type or firm size?	d. Distribution of benefits: distributed differently by firm type or firm size?
2.3. Are the costs and benefits of this discretion independent of all the others or does this ND have some linkages with other NDs that may need to be taken into account?	
3. Net impact of policy options	
3.1. If there is a clear CBA case for retaining or removing the discretion, explain it based on the discussion in 2.1 (i.e. clear evidence of costs and no obvious benefits plus no additional compliance costs from removing the discretion)	
3.2. If the CBA case is ambiguous, could the discretion still be removed? (on the grounds that whatever the costs and benefits are, they are expected to be small and not transferable to other MS)	

Annex: Comprehensive overview of the analysis and advice on each option and national discretion

This Annex, presenting CEBS's analysis and advice on each provision included in the scope of its work is organized in the following manner:

1. **Overview of exercise:** Based on the data currently published on CEBS's website under the supervisory disclosure framework, CEBS presents statistical information on the exercise of the national discretion by its Members. This information is correct to the best of CEBS's knowledge, but when the responsibility for the supervision of investment firms lies with separate national authorities the information can sometimes be incomplete.

2. **Reasoning and proposal:** CEBS proposes a solution to deal with the option/national discretion and presents its reasoning which takes into account the high level Impact Assessment and also the feedback received from the public consultation.

3. **Drafting proposal**: If necessary, a drafting proposal is included to implement the solution CEBS is proposing.

4. **Other remarks**: If necessary, CEBS also highlights the implications of its proposal for the supervisory disclosure framework or provides some extra reasoning for its proposal.

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Area: Own Funds

1. Own Funds, Article 57 (Directive 2006/48/EC)

"Subject to the limits imposed in Article 66, the unconsolidated own funds of credit institutions shall consist of the following items: […]

(b) reserves within the meaning of Article 23 of Directive 86/635/EEC and profits and losses brought forward as a result of the application of the final profit or loss; […]

For the purposes of point (b), the Member States may permit inclusion of interim profits before a formal decision has been taken only if these profits have been verified by persons responsible for the auditing of the accounts and if it is proved to the satisfaction of the competent authorities that the amount thereof has been evaluated in accordance with the principles set out in Directive 86/635/EEC and is net of any foreseeable charge or dividend."

Objective of the discretion: This national discretion allows Member States to specify the composition of own funds. By including verified interim profits credit institutions have the possibility of increasing the amount of own funds.

1. **Overview of exercise:** 83% of Member States have exercised this national discretion, 7% of which with conditions and 17% Member States have not exercised it.

2. **Reasoning and proposal:** As the discretion in Art. 57 is exercised by the majority of Member States and as the Article also states explicit and clear conditions to be fulfilled for making use of it, there is no necessity to keep it as a national discretion. The assessment of whether the criteria are fulfilled can be done by any of the parties involved. In that case, the standard supervisory process is to give the responsibility to the credit institution, subject to the normal challenge process of the supervisor (as referred to in the Article).. As a result, transforming the national discretion into **an option for credit institutions** is proposed. This will allow credit institutions to have the benefit of those interim profits which are verified in accordance with the criteria, and thus create a level playing field in the EU. One member (Lithuania) notes, however, that it does not agree with the other members and would have preferred to retain this discretion under the control of supervisors. Lithuania currently only allows the inclusion of interim profits in Tier 1 capital if additional domestic criteria (e.g. performance of prudential requirements, concentration of loans and assets and the rate of growth of riskier assets, quality of the bank's risk management) are met by the credit institutions.

   As the text of the provision already clearly indicates that such interim - be they the result of a monthly, quarterly, or semi-annual interim statement - profits, can be taken into account if the specific conditions mentioned in Article 57 are fulfilled, no further clarification of the text is deemed necessary.

3. **Drafting proposal:**

For the purposes of point (b), credit institutions may include interim profits before a formal decision has been taken if these profits have been verified by persons responsible for the auditing of the accounts and if it is proved to the satisfaction of the competent authorities that the amount thereof has been evaluated in accordance with the principles set out in Directive 86/635/EEC and is net of any foreseeable charge or dividend.

2. Own Funds, Article 58 (Directive 2006/48/EC)

"Where shares in another credit institution, financial institution, insurance or reinsurance undertaking or insurance holding company are held temporarily for the purposes of a financial assistance operation designed to reorganise and save that entity, the competent authority may waive the provisions on deduction referred to in points (l) to (p) of Article 57".

Objective of the discretion: This discretion allows competent authorities not to deduct certain temporarily held shares from own funds (resulting in a higher amount of own funds). This is based on prudential considerations.

1. **Overview of exercise:** 73% of Member States have exercised this discretion, 3% of which with conditions. 27% of Member States state that they do not exercise it.

2. **Reasoning and proposal:** This provision is seen as helpful in times of crises and differences in its exercise are perceived by most stakeholders as not having a significant impact. The exercise of this discretion has to be decided on a case by case basis, as indicated by the provision itself. This is important for several reasons: (a) it gives an incentive to participate in assistance operations, (b) it allows for the varying degrees of riskiness of such investments (financial assistance might be quite risky and not temporary), (c) the use of it is limited (stability of the banking system as main argument) and (d) the different nature of such investments can be considered. In fact, it is CEBS's opinion that this provision **is not intended to be a national discretion, but a supervisory decision** to be applied on a case by case basis that should have been implemented and applied as such by all Member States (the provision says "the competent authority may waive" and not the Member States). Member States that have not yet implemented this provision as a supervisory decision to be used on a case by case basis should be urged to do so as soon as possible.

3. **Drafting proposal:** No change necessary at the CRD level, but the provision should be implemented as a supervisory decision at the national level.

3. Own Funds, Article 59 (Directive 2006/48/EC)

"As an alternative to the deduction of the items referred to in points (o) and (p) of Article 57, Member States may allow their credit institutions to apply mutatis mutandis methods 1, 2 or 3 of Annex I to Directive 2002/87/EC. Method 1

(accounting consolidation) may be applied only if the competent authority is confident about the level of integrated management and internal control regarding the entities which would be included in the scope of consolidation. The method chosen shall be applied in a consistent manner over time".

Objective of the discretion: This national discretion allows Member States to permit the use of alternative methodologies (Annex I Conglomerates Directive) for the calculation of capital adequacy instead of the deduction from own funds of certain participations (reinsurance undertakings, insurance holding companies) and capital instruments.

1. **Overview of exercise:** 57% of Member States have exercised this national discretion and 43% Member States have not exercised it.

2. **Reasoning and proposal:** The differing exercise of the discretion has no impact for the stakeholders in general, as set out in the review of own funds by the joint task force of the Interim Working Committee on Financial Conglomerates (IWCFC). It is to be noted that the IWCFC and the European Financial Conglomerates Committee are currently discussing the methods of consolidation. An eventual change to this provision should desirably be aligned with the results of their work. The advice of the IWCFC was given on 7 April 2008 including the proposal to delete method 3. If this is adopted in the FCD, the corresponding national discretion to use method 3 in Article 59 Dir. 2006/48/EC should be deleted at the same time.

   According to the Financial Conglomerates Directive (2002/87/EC): "Member States shall allow their competent authorities, where they assume the role of coordinator with regard to a particular financial conglomerate, to decide, after consultation with the other relevant competent authorities and the conglomerate itself, which method shall be applied by that financial conglomerate." In essence this is in respect of supplementary supervision of a financial conglomerate and need not, therefore, necessarily be the same as for the CRD as applied to credit institutions on a solo basis. However, supervisors should be encouraged to align their solo treatment as far as possible with any group calculation to minimise any unnecessary cost to the industry. CEBS also notes that the option to use method 1 is already a supervisory decision. Based on the above, CEBS's proposal is to **transform the national discretion into a supervisory decision (governing the use of any of the three methods)**, with the use of method 1 (accounting consolidation) remaining dependent on the competent authority being "confident about the level of integrated management and internal control […]".This proposal would allow supervisors to liaise with each other and coordinate their approaches in order to reduce the burden for the industry.

3. **Drafting proposal:**

As an alternative to the deduction of the items referred to in points (o) and (p) of Article 57, competent authorities may allow their credit institutions to apply mutatis mutandis methods 1, 2 or 3 of Annex I to Directive 2002/87/EC. Method 1 (accounting consolidation) may be applied only if the competent authority is confident about the level of integrated management and internal control regarding the entities which would be included in the scope of

consolidation. The method chosen shall be applied in a consistent manner over time.

4. Own Funds, Article 60 (Directive 2006/48/EC)

"Member States may provide that for the calculation of own funds on a stand-alone basis, credit institutions subject to supervision on a consolidated basis in accordance with Chapter 4, Section 1, or to supplementary supervision in accordance with Directive 2002/87/EC, need not deduct the items referred to in points (l) to (p) of Article 57 which are held in credit institutions, financial institutions, insurance or reinsurance undertakings or insurance holding companies, which are included in the scope of consolidated or supplementary supervision".

Objective of the discretion: This national discretion allows Member States to decide not to deduct certain holdings and participations in institutions included in the scope of their consolidation from solo-level own funds (resulting in a higher amount of own funds on an unconsolidated basis). This national discretion is based on prudential considerations.

1. **Overview of exercise:** 63% of Member States have exercised this national discretion, 7% of which with conditions and 37% of Member States have not exercised it.

2. **Reasoning and proposal:** There are contradictory supervisory positions both on the content and impact of the differing exercise of this national discretion (i.e. "Individual firms, rather than groups, have obligations to consumers and this is the fundamental reason for setting solo prudential requirements" versus "When institutions are subject to supervision on a consolidated basis, there is no need to deduct the participations"). Though it is noted that the industry favours either giving institutions the option or deleting the discretionary part of the provision, this subject should be dealt with in the context of the expected general review of the definition of own funds. The proposal is **to keep the provision as the review of the definition of own funds is in progress**. The BCBS has started work on this review.

3. **Drafting proposal:** No change necessary.

5. Own Funds, Articles 61, 63.1, 64.3 and 65 (Directive 2006/48/EC)

"61. The concept of own funds as defined in points (a) to (h) of Article 57 embodies a maximum number of items and amounts. The use of those items and the fixing of lower ceilings, and the deduction of items other than those listed in points (i) to (r) of Article 57 shall be left to the discretion of the Member States.

63.1. The concept of own funds used by a Member State may include other items provided that, whatever their legal or accounting designations might be, they have the following characteristics: […]

64.3. Member States or the competent authorities may include fixed-term cumulative preferential shares referred to in point (h) of Article 57 and subordinated loan capital referred to in that provision in own funds, if […]

65. Where the calculation is to be made on a consolidated basis, the consolidated amounts relating to the items listed under Article 57 shall be used in accordance with the rules laid down in Chapter 4, Section 1. Moreover, the following may, when they are credit ('negative') items, be regarded as consolidated reserves for the calculation of own funds: […]"

Objective of the discretion: This national discretion allows Member States to define the composition of own funds (resulting in a higher or lower level of own funds).

1. **Overview of exercise:** 87% of Member States exercise this national discretion, 17% of which with conditions and 7% of Member States state that they do not exercise it.

2. **Reasoning and proposal:** A common definition of own funds is strongly favoured. Until this is available, a change to this national discretion would have significant consequences for limited benefit. It is, however, noted that the differing exercise of the discretion is perceived by a significant number of stakeholders to give rise to competitive distortions (with regard to limit setting, deduction requirements, minority interests and the transferability of excess capital held in subsidiaries). This subject should be dealt with in the context of the expected general review of the definition of own funds. The proposal on this discretion is **to keep it as the review of the definition of own funds is in progress**. The BCBS has started work on this review.

3. **Drafting proposal:** No change necessary.

6. Own Funds, Article 13.2 (Directive 2006/49/EC)

"By way of derogation from paragraph 1, the competent authorities may permit those institutions which are obliged to meet the capital requirements calculated in accordance with Articles 21 and 28 to 32 and Annexes I and III to VI to use, for that purpose only, an alternative determination of own funds. […]"

Objective of the discretion: This national discretion allows Member States to introduce an alternative method of own funds calculation for certain investment firms.

1. **Overview of exercise:** 53% of Member States exercise this national discretion, 3% of which with conditions and 34% of Member States are not exercising it.

2. **Reasoning and proposal:** A common definition of own funds is strongly favoured. Until this is available, a change to this national discretion would have significant consequences for limited benefit. It should also be noted that only a minority of stakeholders expect any impact to result from the differing exercise of the discretion. This subject should be dealt with in the context of the expected general review of the definition of own funds. The proposal on this discretion is **to keep it as the review of the definition of own funds is in progress**. The BCBS has started work on this review.

3. **Drafting proposal:** No change necessary.

7. Own Funds, Article 13.5 (Directive 2006/49/EC)

"The competent authorities may permit institutions to replace the subordinated loan capital referred to in point (c) of the second subparagraph of paragraph 2 with points (d) to (h) of Article 57 of Directive 2006/48/EC."

Objective of the discretion: To give institutions more flexibility regarding the composition of own funds. If an institution is calculating its own funds in accordance with the alternative offered in Article 13.2 of Directive 2006/49/EC, it can be allowed to substitute subordinated loans with other elements described in Article 57 of Directive 2006/48/EC, mainly as Tier 2. It allows the institution to replace Tier 3 capital with excess Tier 2 capital which cannot be recognised as own funds because of Article 66(1) (a) of Directive 2006/48. The assumption behind this rule is that Tier 2 capital is of better quality than Tier 3 capital. Some Member States do not recognise Tier 3 capital. The origin of the rule is the Basel market risk amendment of 1996).

1. **Overview of exercise**: 30% of Member States have exercised the discretion and 56% have not.

2. **Reasoning and proposal:** Against the background that this national discretion, on the one hand, allows a more flexible treatment for institutions but, on the other hand, is prudentially no less conservative, it is proposed to leave the discretion to institutions rather than to supervisors. Cross border implications are limited and the impact on credit institutions and investment firms is none or very limited; for countries which allow Tier 3 to support short-term trading-book risk, it does not make sense to disallow this option. The proposal is to change the national discretion into an **option for institutions**. This would not change the treatment in Member States which have decided not to recognise Tier 3 capital components. As the definition of capital will be reviewed in the coming years, one could argue for waiting for this revision. However, leaving the choice to the institutions does not change the capital definition as such.

3. **Drafting proposal**:

Institutions may substitute the subordinated loan capital referred to in point (c) of the second subparagraph of paragraph 2 with points (d) to (h) of Article 57 of Directive 2006/48/EC.

8. Own Funds, Article 14 (Directive 2006/49/EC); 14(1) for investment firms, 14 (2) for credit institutions

"The Competent Authorities may permit investment firms to exceed the ceiling for subordinated loan capital set out in Article 13(4) if they judge it prudentially adequate and provided that (…)

The competent authorities may permit the ceiling for subordinated loan capital set out in Article 13(4) to be exceeded by a credit institution if they judge it prudentially adequate and provided that (…)"

Objective of the discretion: More generous rule, extension of the capital base of credit institutions and investment firms, permitting them to hold subordinated capital (Tier 3) in excess of ordinary thresholds, up to certain limits.

1. **Overview of exercise**: 37% of Member States have exercised the discretion, 7% of which with conditions and 47% have not.

2. **Reasoning and proposal**: Against the background of the split positions of Members and the fact that the revision of the own funds rules is on the horizon, it would probably be best to leave the content of this discretion as it is. This provision has level playing field implications because credit institutions which can use the option have a broader capital base available. The application is dependent on whether it is prudentially adequate for the specific institution and other criteria are fulfilled. This presupposes supervisory judgement on a case by case basis, which is also the way the provision is phrased, though in practice not the way it was implemented by all Member States in domestic law. As this provision **is not intended to be a national discretion, but a supervisory decision** to be applied on a case by case basis, it should have been implemented and applied as such in all Member States (the provision says "the competent authority may allow" and not the Member State). The text from the Directive should be kept unchanged and the Member States that have not yet implemented this provision as a supervisory decision to be used on a case by case basis should be urged to do so as soon as possible.

3. **Drafting proposal:** No change necessary at the CRD level, but the provision should be implemented as a supervisory decision at the national level.

4. **Other remarks**: The CEBS supervisory disclosure framework should differentiate between Article 14(1) (which concerns investment firms) and Article 14(2) (which concerns credit institutions).

Area: Scope of Application

9. Scope of application, Article 69.1 (Directive 2006/48/EC)

"The Member States may choose not to apply Article 68(1) to any subsidiary of a credit institution, where both the subsidiary and the credit institution are subject to authorisation and supervision by the Member State concerned, and the subsidiary is included in the supervision on a consolidated basis of the credit institution which is the parent undertaking, and all of the following conditions are satisfied, in order to ensure that own funds are distributed adequately among the parent undertaking and the subsidiaries: (…)"

Objective of the discretion: Enables a reduction in the regulatory burden on banking groups by partially waiving the prudential requirements on a solo basis.

1. **Overview of exercise:** Currently 40% of Member States exercise the discretion and 60% of Member States do not.

2. **Reasoning and proposal:** The impact of the differing exercise of this national discretion is considered to be immaterial by some stakeholders that support keeping it. It is material, however, for cross-border banks where the current situation penalises parent institutions with a larger number of subsidiaries outside the home jurisdiction, as opposed to those institutions whose subsidiaries are established in the same jurisdiction as the parent entity. On the other hand, this is a fundamental discretion that provides necessary flexibility for the implementation of the CRD and is closely linked with domestic insolvency rules and depositor protection rules. On balance, CEBS believes that reviewing this discretion would impact on the existing compromise on the scope of its application and should, therefore, only be done in the context of a full review of the subject, which is outside of the scope of the current exercise. The national discretion should be **kept in its present form**.

3. **Drafting proposal:** No change necessary.

10. Scope of Application, Article 69.3 (Directive 2006/48/EC)

"The Member States may choose not to apply Article 68(1) to a parent credit institution in a Member State where that credit institution is subject to authorisation and supervision by the Member State concerned, and it is included in the supervision on a consolidated basis, and all the following conditions are satisfied, in order to ensure that own funds are distributed adequately among the parent undertaking and the subsidiaries: (…) The competent authority which makes use of this paragraph shall inform the competent authorities of all other Member States."

Objective of the discretion: Enables reduction of the regulatory burden on the banking groups by partially waiving the prudential requirements on a solo basis.

1. **Overview of exercise:** Currently 20% of Member States exercise the discretion and 80% Member States do not.

2. **Reasoning and proposal**: As in substance this national discretion is similar to discretion 9 the same reasoning applies. **The national discretion should be kept in its present form.**

3. **Drafting proposal:** No change necessary.

11. Scope of application, Article 70 (Directive 2006/48/EC)

"Subject to paragraphs 2 to 4 of this Article, the competent authorities may allow on a case by case basis parent credit institutions to incorporate in the calculation of their requirement under Article 68(1) subsidiaries which meet the conditions laid down in points (c) and (d) of Article 69(1), and whose material exposures or material liabilities are to that parent credit institution. (…)"

Objective of the discretion: Enables the reduction of the regulatory burden on credit institutions by partially modifying the prudential requirements on a solo basis.

1. **Overview of exercise**: Currently 37% of Member States exercise the discretion, 3% of which with a proviso and 63% of Member States do not exercise the discretion.

2. **Reasoning and proposal**: Since possible divergence in the exercise of the discretion is not seen as an issue and it mostly concerns the non-supervised entities within a group, there is no apparent need to remove the discretion. The discretion provides necessary flexibility for the implementation of the CRD and is closely linked with national tax regimes, insolvency rules and depositor protection rules. A revision would also impact on the existing compromise on the scope of its application and should, therefore, only be done in the context of a full review of the subject. It should, however, be clear that this provision **is not intended to be a national discretion, but a supervisory decision** to be applied on a case by case basis that should have been implemented and applied as such in all Member States (the provision says "the competent authority may allow on a case by case basis"). The text of the Directive should be kept unchanged and the Member States that have not yet implemented this provision as a supervisory decision to be used on a case by case basis should be urged to do so as soon as possible.

3. **Drafting proposal:** No change necessary at the CRD level, but the provision should be implemented as a supervisory decision at the national level.

12. Scope of application Article 72.3 (Directive 2006/48/EC)

"The competent authorities responsible for exercising supervision on a consolidated basis pursuant to Articles 125 and 126 may decide not to apply in full or in part paragraphs 1 and 2 to the credit institutions which are included within comparable disclosures provided on a consolidated basis by a parent undertaking established in a third country."

Objective of the discretion: Enables the reduction of the regulatory burden on banking groups.

1. **Overview of exercise**: Currently 57% of Member States exercise the discretion, 7% of which with a proviso and 43% of Member States do not exercise the discretion.

2. **Reasoning and proposal:** Seeing that the presence of subsidiaries of third country credit institutions with equivalent disclosure requirements is rather limited, the impact of the divergence cannot be considered substantial. In fact this provision **is not intended to be a national discretion, but a supervisory decision** to be applied on a case by case basis that should have been implemented in this way by all Member States (the provision says "the competent authority… may decide" and not the Member State). It should also be applied as such. The text from the Directive should be kept unchanged and the Member States that have not yet implemented this provision as a supervisory decision to be used on a case by case basis should be urged to do so as soon as possible. Such implementation will not impact on the current state of play regarding the scope of application.

   Although it would be possible to agree on criteria for the assessment of comparability for Pillar 3 disclosures, this would imply going through full equivalence assessments. The burden and costs of this process (directly for the supervisors and thus in most Member States indirectly for the industry and/or the State) would be likely to outweigh the benefits from the eventual removal of the subjectivity in this supervisory decision. However, the competent authorities who are in similar positions vis-à-vis third countries should consult each other to ensure a harmonised approach.

3. **Drafting proposal:** No change necessary at the CRD level, but the provision should be implemented as a supervisory decision at the national level, the exercise of which could usefully be based on discussions between the competent authorities involved.

13. Scope of application, Article 73.1 (Directive 2006/48/EC)

"The Member States or the competent authorities responsible for exercising supervision on a consolidated basis pursuant to Articles 125 and 126 may decide in the following cases that a credit institution, financial institution or ancillary services undertaking which is a subsidiary or in which a participation is held need not be included in the consolidation: (…)"

Objective of the discretion: The national discretion allows Member States to determine the scope of the group for the purposes of consolidation.

1. **Overview of exercise:** Currently 93% of the Member States exercise the discretion, 17% of which with a proviso and 7% of the Member States do not exercise the discretion.

2. **Reasoning and proposal**: This discretion is widely exercised by Member States and most stakeholders perceive no impact from the differing exercise of it. The proposal is to **transform it into a supervisory decision** to be applied on a case by case basis by deleting the alternative allocation of this option to the Member State. Competent authorities can then clarify which types of institutions need not be included in the consolidation. Since most of the criteria referred to in Article 73.1 are subject to interpretation, CEBS's view is that only the competent authorities are in position, prudently, to interpret and assess the application of these criteria against their supervisory objectives. This technical change will not impact the current state of play regarding the scope of its application.

3. **Drafting proposal:**

The competent authorities responsible for exercising supervision on a consolidated basis pursuant to Articles 125 and 126 may decide in the following cases that a credit institution, financial institution or ancillary services undertaking which is a subsidiary or in which a participation is held need not be included in the consolidation: (…)

14. Scope of application, Articles 22, 24 & 25 (Directive 2006/49/EC)

"22(1) The competent authorities required or mandated to exercise supervision of groups covered by article 2 on a consolidated basis may waive, on a case by case basis, the application of capital requirements on a consolidated basis provided that (specific conditions related to investment firms…)

22(2)By way of derogation from paragraph 1, competent authorities may permit financial holding companies which are the parent financial holding company in a Member State of an investment firm in such a group to use a value lower than the value calculated under (…)

24(1) By way of derogation from Article 2(2), competent authorities may exempt investment firms from the consolidated capital requirements (…)

25 (1) By way of derogation from Article 2(2), competent authorities may exempt investment firms from the consolidated capital requirement (…)"

Objective of the discretion: Competent authorities may exempt investment firms, on a case by case basis, from the consolidated capital requirements provided that all the investment firms in the group meet certain conditions. The national discretion provides for a proportionate approach to capital requirements for groups consisting of investment firms with limited activities and/or licences.

1. **Overview of exercise**: Currently 34% of the Member States exercise the discretion, 7% of which with a proviso, 46% of the Member States do not exercise the discretion.

2. **Reasoning and proposal**: The divergence in the exercise of this discretion is not seen as problematic. There are essentially three separate discretions that should be grouped as follows:

    a. Article 22 should not be classified as a national discretion. In fact this provision **is not intended to be a national discretion, but a supervisory decision** (the provision says "the competent authority… may waive on a case by case basis" and not the Member States) to be applied on a case by case basis which should have been implemented in this way by all Member States. Indeed, Article 22 already explicitly includes the case by case provision. It should also be applied as such. The text from the Directive should be kept unchanged and the Member States that have not yet implemented this provision as a supervisory decision to be used on a case by case basis should be urged to do so as soon as possible. Part 1 of Article 22 sets out various conditions which need to be fulfilled by the institution before a waiver can be considered. As the article explicitly provides for a "waiver", CEBS believes that this requires some element of supervisory judgement and as such these conditions should be regarded as a minimum which competent authorities should consider when making their decision on a case by case basis. (For example, competent authorities may wish to consider whether the "systems to monitor and control the sources of capital and funding" are indeed adequate in a particular case). The suggested implementation as a supervisory decision will not impact on the current state of play regarding the scope of its application. Article 22 is intended to allow a proportionate approach to the limited licence and limited activity investment firms within its scope.

    b. Articles 24 and 25, on the other hand, specify how to apply own funds at the consolidated level for investment firm groups where the discretion (to 'waive' consolidation) in Article 22 has not been exercised. These provisions are designed to provide for a more appropriate and proportionate approach for dealing with the risk within groups that consist of limited licence and/or limited activity investment firms. This reflects application of a fixed overheads requirement rather than an operational risk charge for such investment firms to help ensure an orderly wind-down in the event of problems. The three paragraphs in Articles 24 and 25 can be replaced by a proportionate application of the own funds requirements laid down in Article 20 of Directive 2006/49/EC by making it an **option for investment firms**. Such proportionate implementation will not impact on the current state of play regarding the scope of its application.

3. **Drafting proposal:** No change necessary at the CRD level for Article 22, but it should be implemented as a supervisory decision at the national level. Proposals for Articles 24 and 25:

Article 24: *24 (1). By way of derogation from Article 2(2), where all the investment firms in the group are covered by Article 20(2) and the group does not include credit institutions, the investment firms in the group may choose not to apply*

the consolidated capital requirement established in Article 2(2) provided that the requirements of Article 24(2) or Article 24(3) are met instead.

24 (2). Where the option in paragraph 1 is exercised, a parent investment firm (…)

24 (3). Where the option in paragraph 1 is exercised, an investment firm controlled (…)

Article 25:

By way of derogation from Article 2(2), where all the investment firms in the group fall within the investment firms referred to in Article 20(2) and (3) and the group does not include credit institutions, the investment firms in the group may choose not to apply the consolidated capital requirement established in Article 2(2) provided that the requirements of the second or third paragraph of this Article are met instead."

Where the option in the first paragraph is exercised, a parent investment firm in a Member State (…)

Where the option in the first paragraph is exercised, an investment firm controlled by a financial holding company (...)

Area: Counterparty Risk in Derivatives

15. Counterparty Risk in Derivatives, Annex III, Part 3 (Directive 2006/48/EC) (text above table 2)

"For the purpose of calculating the potential future credit exposure in accordance with step (b) the competent authorities may allow credit institutions to apply the percentages in Table 2 instead of those prescribed in Table 1 provided that the institutions make use of the option set out in Annex IV, point 21 to Directive 2006/49/EC for contracts relating to commodities other than gold within the meaning of paragraph 3 of Annex IV, to this Directive: (table)."

Objective of the discretion: For institutions complying with certain requirements in their trading activities in commodities, gold and other products, competent authorities may allow percentages for the calculation of potential future value other than the general ones. The discretion allows for a larger degree of differentiation (capital requirements) with respect to specific commodity categories. However, it leads in all cases to lower capital requirements for these categories.

1. **Overview of exercise**: 33% of the Member States exercise this discretion; 67% have not exercised the discretion.

2. **Reasoning and proposal**: On the one hand, the provision provides for a larger degree of differentiation between different products. On the other hand, the specified treatment leads in all cases to lower capital requirements. However, authorisation to use the proposed treatment is only possible if an

institution meets the criteria in Annex IV, point 21 of the CAD which are: a) to undertake significant commodities business, b) to have a well diversified portfolio and c) not yet to be in a position to use internal models. Therefore, this can probably be justified by the assumption that the requirements for such institutions to have a) significant commodity business and b) a well diversified portfolio should help them understand and manage the prudential risk. Nevertheless, there is still the question whether an institution with significant commodities business should not be using an internal model for the calculation of capital requirements. However, this is probably not necessary for smaller institutions. Therefore, the deletion of the discretion could be a disadvantage for smaller institutions with significant commodities business and which are well diversified. Leaving the choice to the discretion of credit institutions does not seem to be an option because it provides a less prudent treatment. Mutual recognition also seems not to be an option because it would not really help alleviate the possible downside of this discretion. The cross border implications are limited as large international institutions are expected to use internal models and no implications for regional markets are foreseen. The discretion is apparently not used by larger institutions. Taking into account the pros and cons and considering that this discretion allows supervisors to deal with small commodities firms in a proportionate way and that its divergent exercise has no significant impact, the proposal is to **keep the national discretion as it is.**

3. **Drafting proposal**: No change necessary.

16. Counterparty Risk in Derivatives, Annex III, Part 6, point 7 (Directive 2006/48/EC)

"(…) alpha (α) shall be 1.4, but competent authorities may require a higher α, and effective EPE shall be computed by estimating expected exposure (EEt) as the average exposure at future date t, where the average is taken across possible future values of relevant risk factors. (…)"

Objective of the discretion: Possibility for a supervisor (on a case by case basis) to require higher capital requirements (exposure values) depending on the risk characteristics of a firm's portfolio.

1. **Overview of exercise**: 60% of Member States use this discretion.

2. **Reasoning and proposal**: According to the general provision in Annex III, Part 6, point 1("Subject to the approval of the competent authorities, a credit institution may use the Internal Models Method…") it would still be for supervisors to decide whether specific portfolios do require alphas higher than 1.4. This discretion is in fact **part of the overall supervisory approval process for the model**. The provision could be amended to make clear that the amount of alpha would be a case by case decision which will be taken in the overall context of the model approval, taking into account the characteristics of the portfolio of the firm (instead of requiring a stand alone decision on one component of the model). A separate explicit approval of alpha is not necessary. Cross border implications are limited or zero and the diverging exercise of the discretion has no impact. According to evidence

provided by ISDA for portfolios of large international firms, normally an alpha of 1.4 would be sufficient. Higher alphas were primarily provided for smaller firms with less diversified portfolios.

3. **Drafting proposal**:

(…) alpha (α) shall be not less than 1.4 and effective EPE shall be computed by estimating expected exposure (EEt) as the average exposure at future date t, where the average is taken across possible future values of relevant risk factors (…)

17. Counterparty Risk in Derivatives, Annex III, Part 6, point 12 (Directive 2006/48/EC)

"Notwithstanding point 7, competent authorities may permit credit institutions to use their own estimates of α, subject to a floor of 1, 2 (…)"

Objective of the discretion: Possibility for credit institutions to apply an even more advanced modelling approach.

1. **Overview of exercise:** 77% of Member States have exercised this discretion.

2. **Reasoning and proposal**: The use of internal estimates of alpha is **part of the supervisory approval process of the model.** The main interest of supervisors is to decide if an institution is able to calculate alpha internally or not, and this decision will be taken during the model approval process. As Annex III, Part 6 point 1 Dir. 2006/48/EC already determines that credit institutions may use the Internal Models Method only with prior approval by their competent authorities and as the decision on whether internal estimates of alpha can be used is already included into this, an explicit approval of alpha is not necessary. The provision can be amended to clarify that it is part of the model approval process.

3. **Drafting proposal**:

Notwithstanding point 7, credit institutions may use their own estimates of α, subject to a floor of 1.2, where α shall equal the ratio of internal capital from a full simulation of CCR exposure across counterparties (numerator) and internal…

18. Counterparty Risk in Derivatives, Annex III, Part 7c (ii) (Directive 2006/48/EC)

"- NGR = 'net to gross ratio': at the discretion of the competent authorities, either: (i) separate calculation: (…) or (ii) aggregate calculation: (…)

If Member States permit credit institutions a choice of methods, the method chosen is to be used consistently."

Objective of the discretion: The national discretion allows for a choice between two calculation methods when calculating the 'net-to-gross ratio'.

1. **Overview of exercise**: 70% of Member States have explicitly stated that they allow a choice and 30% of Member States allow only the separate calculation method.

2. **Reasoning and proposal**: In the opinion of CEBS, the aggregate calculation is too broad, less specific and thus less risk sensitive than the separate calculation. As the burden of implementation of each of the options seems to be equal, CEBS has considered two options: (a) the aggregate calculation method, i.e. the less risk sensitive option should be deleted, or (b) the possibility of deciding which method may be used should remain in the hands of supervisors. Respondents favour keeping both options open and, though the supervisory role is not contested, they think it should be part of the approval process/supervisory challenge. On balance, CEBS sees no benefit in keeping two separate options, which reduce harmonisation, and proposes to keep the more risk sensitive approach. As a result the **possibility of using the aggregate calculation should be deleted**.

3. **Drafting proposal**: Deletion of the sentence "If Member States permit credit institutions a choice of methods, the method chosen is to be used consistently" and rewording the definition of NGR as follows:

   "- NGR = '*net-to-gross ratio': the quotient of the net replacement cost for all contracts included in a legally valid bilateral netting agreement with a given counterparty (numerator) and the gross replacement cost for all contracts included in a legally valid bilateral netting agreement with that counterparty (denominator).*"

4. **Other remarks:** The wording of the national discretion is not consistent. The introductory sentence reads: "at the discretion of the competent authorities", the sentence after the discretion reads: "If Member States permit…"

Area: Standardised approach for credit risk

19. Standardised approach, Article 80.3 and Annex VI, Part 1, Point 24 (Directive 2006/48/EC)

"For the purposes of calculating risk-weighted exposure amounts for exposures to institutions, Member States shall decide whether to adopt the method based on the credit quality of the central government of the jurisdiction in which the institution is incorporated or the method based on the credit quality of the counterparty institution in accordance with Annex VI".

Objective of the discretion: This national discretion allows Member States to choose between two methods for the purpose of calculating the capital charge for exposures to institutions.

1. **Overview of exercise:** Member States are equally divided in their use of the two methods.

2. **Reasoning and proposal**: The method based on the credit quality of the counterparty is more risk sensitive than the method based on the credit quality of the central government. In that respect, it is more in line with the idea behind "Basel II". However, in many Member States only a small minority of institutions are externally rated. Consequently, the majority of institutions will get the same risk weight regardless of their credit quality. Institutions in such Member States will be put at a disadvantage if the method based on the credit quality of the central government is removed. As a result of these considerations, stakeholders have very different opinions regarding the two methods based on their national market specificities. CEBS has considered as a possible solution adding a mutual recognition clause, however, in its opinion, this would lead to regulatory arbitrage because there is no clear indication of which competent authority is best placed to assess the choice of methods. Given the significance of this provision in terms of both level playing field and consolidation difficulties for cross-border groups, a majority of the industry expressed a preference to delete one of the options and keep the other. Since the external ratings are not available in many of the Member States, one possibility would be to keep only the method based on the credit quality of the central government. However, CEBS is averse to proposing to keep this less risk sensitive approach and deleting the more risk sensitive approach. Keeping only the method based on the credit quality of the counterparty institution would unduly harm the institutions operating in Member States where ratings are not available. The adverse consequences for cross border banks are recognised but should be limited as most will be on (or will move to) IRB for purposes of consolidated supervision. There is no clear solution in the near future in this area where the market itself, within the EU, has not been harmonized yet. As long as the use of external ratings has not become an EU-wide market standard, the issue cannot be solved at the technical level. The proposal is **to keep the national discretion in its current form**.

3. **Drafting proposal**: No change necessary.

20. Standardised approach, Article 80.7 (Directive 2006/48/EC)

"With the exception of exposures giving rise to liabilities in the form of the items referred to in paragraphs (a) to (h) of Article 57, competent authorities may exempt from the requirements of paragraph 1 of this Article the exposures of a credit institution to a counterparty which is its parent undertaking, its subsidiary, a subsidiary of its parent undertaking or an undertaking linked by a relationship within the meaning of Article 12(1) of Directive 83/349/EEC, provided that the following conditions are met (...)" (amongst which the condition that the counterparty is established in the same Member State as the credit institution).

Objective of the discretion: This discretion allows a more permissive treatment of certain exposures within a Member State if conditions are met.

1. **Overview of exercise:** 70% of Member States exercise the discretion, 10% of which with provisos and 30% do not exercise it.

2. **Reasoning and proposal**: Most stakeholders perceive no impact of the differing exercise of this discretion and most Members think that it should be possible to exempt, in one way or another, these types of intra-group exposures from the capital charge. In CEBS's view, this provision **is not intended to be a national discretion, but a supervisory decision to be applied on a case by case basis** that should have been implemented by all Member States (the provision says "the competent authority may exempt" and not the Member State). The Member States that have not yet implemented this provision should be urged to do so. However, as the national discretion has no cross border effects this is not a high priority. Furthermore, the Directive text could be changed to clarify that the exemption from the requirements of Article 80 paragraph 1 depends on the supervisory judgement of the fulfilment of the conditions set out in the provision (i.e. if the competent authorities are satisfied that the conditions are met the exemption would be granted to that institution). The conditions set limit the rule to prudentially supervised counterparties in the same Member State. The conditions should be kept as they are, pending changes in similar requirements in the own funds area and similar non-cross-border national discretion in the area of the scope of application. The assessment of whether the transfer of capital is hampered within the jurisdiction is closely linked with the prevailing insolvency and depositor protection rules. Some Member States have expressed their concern that, given their legal environment, this condition can never be satisfactorily fulfilled and, therefore, would prefer to retain the possibility of deciding on a general basis not to apply the exemption to the institutions in their jurisdiction.

3. **Drafting proposal**:

With the exception of exposures giving rise to liabilities in the form of the items referred to in paragraphs (a) to (h) of Article 57, competent authorities shall exempt from the requirements (…) provided that the following conditions are met (...)

21. Standardised approach, Article 80.8 (Directive 2006/48/EC)

"With the exception of exposures giving rise to liabilities in the form of the items referred to in points (a) to (h) of Article 57, competent authorities may exempt from the requirements of paragraph 1 of this Article the exposures to counterparties which are Members of the same institutional protection scheme as the lending credit institution, provided that the following conditions are met (...)"

Objective of the discretion: This national discretion allows a more permissive treatment of certain exposures if conditions are met

1. **Overview of exercise:** 23% of Member States exercise the discretion; 77% do not exercise it.

2. **Reasoning and proposal:** This national discretion is important for those few Members where such institutional protection schemes exist and its divergent exercise has no impact. Other Members and trade bodies seem to be indifferent to this Article, which can be justified by the non-existence of such institutional protection schemes in a number of Member States. Taking into account that different exercise of this national discretion has limited impact on cross-border business, the national discretion could be kept in its current form. Moreover, this provision **is not intended to be a national discretion, but a supervisory decision to be applied on a case by case basis** that should have been implemented by all Member States (the provision says "the competent authority may exempt" and not the Member State). This provision should be implemented by all Member States where such schemes exist.

3. **Drafting proposal:** Similar to provision number 20, the Directive text could be changed to clarify that the exemption from the requirements of paragraph 1 depends only on the supervisory judgement of the fulfilment of the conditions set out in the provision.

With the exception of exposures giving rise to liabilities in the form of the items referred to in points (a) to (h) of Article 57, competent authorities shall exempt from the requirements of paragraph 1 of this Article the exposures to counterparties which are Members of the same institutional protection scheme as the lending credit institution, provided that the following conditions are met (...)"

22. Standardised approach, Article 83.2 (Directive 2006/48/EC)

"Credit institutions shall use solicited credit assessments. However, with the permission of the relevant competent authority, they may use unsolicited ratings"

Objective of the discretion: Competent authorities may allow institutions to use unsolicited ratings. This will generally lead to more favourable treatment.

1. **Overview of exercise:** 83% of Member States exercise the discretion, 17% of wich with a proviso and 17% do not exercise it.

2. **Reasoning and proposal**: This provision **is not intended to be a national discretion, but a supervisory decision to be applied on a case by case basis** that should have been implemented by all Member States (the provision says "with the permission of the relevant competent authority" and not the Member State). In principle, the text of the Directive should be kept unchanged and the Member States that have not yet implemented this provision should be urged to do so. As regards the exercise of the supervisory decision, competent authorities have different views about the quality of unsolicited ratings which leads to differing exercise of this provision. A change would have a significant impact in several markets. Therefore, this supervisory decision should be kept in its current form until such time as a common practice has developed in the markets. CEBS clarifies that it is its understanding that the application of this provision is made on a case by case

basis for the ECAIs and not for the credit institutions. In the context of the recognition process, the competent authorities will assess whether unsolicited ratings issued by a particular ECAI can (or cannot) be recognised as eligible for CRD purposes and will apply this decision to all credit institutions under its jurisdiction.

3. **Drafting proposal:** No change necessary at the CRD level, but the provision should be implemented as a supervisory decision at the national level. The Commission could consider simplifying this provision by linking it to the recognition of ECAIs.

Credit institutions shall use solicited credit assessments. However, where the recognition of the ECAI allows the use of unsolicited ratings the credit institutions may use them.

4. **Other remarks:** As noted in 2005/2006 during CEBS's work on the guidelines for the recognition of ECAIs, the use of unsolicited ratings raised concerns among several competent authorities resulting in a lack of consensus on the exercise of this discretion. Most competent authorities allow credit institutions to use unsolicited ratings if the ECAI produces only unsolicited ratings, but if the ECAI issues both solicited and unsolicited ratings practices among competent authorities differ.

23. Standardised approach, Annex VI, Part 1, Point 5 (Directive 2006/48/EC)

"When the competent authorities of a third country which apply supervisory and regulatory arrangements at least equivalent to those applied in the Community assign a risk weight which is lower than that indicated in point 1 to 2 to exposures to their central government and central bank denominated and funded in the domestic currency, Member States may allow their credit institutions to risk weight such exposures in the same manner."

Objective of the discretion: This national discretion allows a more permissive treatment of exposures to central governments and central banks in third countries.

1. **Overview of exercise:** 87% of Member States exercise the discretion, 7% of which with a proviso and 13% do not exercise it.

2. **Reasoning and proposal**: Most stakeholders perceive no or limited impact from the divergent exercise of this discretion. Although there are different opinions about specific details, most Members agree that it is possible to apply a lower capital charge to exposures to central government and central banks in certain third countries. It would be undesirable if Members have different opinions about whether the "supervisory and regulatory arrangements" in a specific third country are equivalent to those applied in the EU. It is proposed to **transform the national discretion into a supervisory decision** adding a reference to an **EU joint assessment process** in the context of the CEBS, inviting all interested competent authorities to share information and opinions

with the intention of reaching a consensus view, similar to the existing process for ECAIs. The outcome of the joint assessment process could be a public list of eligible third countries that would provide a strong common basis on which national competent authorities would take their decisions on the exercise of this supervisory decision. In addition, a **non-binding mutual recognition clause** is proposed to promote convergence and to alleviate the burden of the assessment. Feedback received in the public consultation indicates that market participants welcome the joint assessment process, but also that they would like the outcome of the assessment to be binding on all supervisors. CEBS believes that this would result in a fundamental change to the existing allocation of tasks between CEBS and supervisors and more generally to the current supervisory framework. Such a change falls outside the mandate given by the European Commission and cannot thus be recommended by CEBS. CEBS also points out that the positive experience with the joint ECAI recognition process leads to the conclusion that the established process only has positive consequences for the level of harmonisation.

3. **Drafting proposal:**

When the competent authorities of a third country which apply supervisory and regulatory arrangements at least equivalent to those applied in the Community assign a risk weight which is lower than that indicated in point 1 to 2 to exposures to their central government and central bank denominated and funded in the domestic currency, competent authorities may allow their credit institutions to risk weight such exposures in the same manner.

When the supervisory and regulatory arrangements of a third country need to be evaluated, all relevant competent authorities in the EU shall be invited to participate in a joint assessment. When, as a result of the joint assessment, a competent authority of one Member State subsequently allows their credit institutions to apply a lower risk weight, competent authorities of another Member State may also allow their credit institutions to use a lower risk weight without conducting their own assessment.

24. Standardised approach, Annex VI, Part 1, Point 11 (Directive 2006/48/EC)

"When competent authorities of a third country jurisdiction which apply supervisory and regulatory arrangements at least equivalent to those applied in the Community treat exposures to regional governments and local authorities as exposures to their central government, Member States may allow their credit institutions to risk weight exposures to such regional governments and local authorities in the same manner."

Objective of the discretion: This national discretion allows a more permissive treatment of exposures to regional governments and local authorities situated in a third country.

1. **Overview of exercise:** 83% of Member States exercise the discretion, 3% of which with a proviso and 7% do not exercise it.

2. **Reasoning and proposal**: Most stakeholders perceive no or limited impact from the divergent exercise of this discretion. Although there are different opinions about specific details, most Members seem to agree that it is possible to apply a lower capital charge for exposures to regional governments and local authorities in certain third countries. It would be undesirable if Members have different opinions about whether the "supervisory and regulatory arrangements" in a specific third country are equivalent to those applied in the EU. It is proposed to **transform the national discretion into a supervisory decision** adding a reference to an **EU joint assessment process** in the context of CEBS, inviting all interested competent authorities to share information and opinions, with the intent of reaching a consensus view, similar to the existing joint process for ECAIs. The outcome of the joint assessment process should be a public list of eligible third countries that would provide a strong common basis on which national competent authorities would take their decisions on the exercise of this supervisory decision. In addition a **non-binding mutual recognition clause** is proposed to promote convergence and to alleviate the burden of the assessment. Feedback received in the public consultation indicates that market participants welcome the reference to a joint assessment process, but also that they would like the outcome of this assessment to be binding to all supervisors. CEBS believes that this would result in a fundamental change to the existing allocation of tasks between CEBS and supervisors and more generally to the current supervisory framework. Such a change falls outside the mandate given by the European Commission and cannot thus be recommended by CEBS. CEBS also points out that the positive experience with the joint ECAI recognition process leads to the conclusion that the established process only has positive consequences for the level of harmonisation.

3. **Drafting proposal**:

When competent authorities of a third country jurisdiction which apply supervisory and regulatory arrangements at least equivalent to those applied in the Community treat exposures to regional governments and local authorities in the same way as exposures to their central government, competent authorities may allow their credit institutions to risk weight exposures to such regional governments and local authorities in the same manner.

When the supervisory and regulatory arrangements of a third country need to be evaluated, all relevant competent authorities in the EU shall be invited to participate in a joint assessment. When, as a result of the joint assessment, a competent authority of one Member State subsequently allows their credit institutions to treat exposures to third country regional governments and local authorities as exposures to the third country central government, competent authorities of another Member State may also allow their credit institutions this without conducting their own assessment.

25. Standardised approach, Annex VI, Part 1, Point 14 (Directive 2006/48/EC)

"Subject to the discretion of competent authorities, exposures to public sector entities may be treated as exposures to institutions. Exercise of this discretion by competent authorities is independent of the exercise of discretion as specified in Article 80(3). The preferential treatment for short-term exposures specified in points 31, 32 and 37 shall not be applied."

Objective of the discretion: More permissive treatment of exposures to public sector entities.

1. **Overview of exercise:** Currently 77% of Member States exercise the discretion, 7% of which with a proviso and 23% of Member States do not exercise the discretion.

2. **Reasoning and proposal**: The treatment of local PSEs in Member States requires local judgement as well as a case by case approach (risk specificities of PSEs across Member States e.g. due to different legal status or guarantee schemes). This provision is not intended to be a national discretion, but a supervisory decision to be applied on a case by case basis that should have been implemented by all Member States (the provision says "subject to the discretion of competent authorities" and not the Member States). The text of the Directive should be kept unchanged – a **supervisory decision with the binding mutual recognition clause included in point 16** - and the Member States that have not yet implemented this provision should be urged to do so.

3. **Drafting proposal**: The following wording could be added at the end of the current point 14:

[….] Competent authorities exercising this discretion shall draw up and make public the criteria used and/or the list of their public sector entities treated as institutions in the context of the supervisory disclosure framework referred to in Article 144 of this Directive.

26. Standardised approach, Annex VI, Part 1, Point 15 (Directive 2006/48/EC)

"In exceptional circumstances, exposures to public sector entities may be treated as exposures to the central government in whose jurisdiction they are established where in the opinion of the competent authorities there is no difference in risk between such exposures because of the existence of an appropriate guarantee by the central government."

Objective of the discretion: More permissive treatment of exposures to public sector entities if certain conditions are met.

1. **Overview of exercise:** Currently 80% of Member States exercise the discretion, 13% of wich with a proviso and 20% of Member States do not exercise the discretion.

2. **Reasoning and proposal**: The treatment of local PSEs in Member States requires local judgement as well as a case by case approach (risk specificities of PSEs such as the explicit existence of a contract, the legal regime of the entity). This provision **is not intended to be a national discretion, but a supervisory decision** to be applied on a case by case basis that should have been implemented by all Member States (the provision says "in the opinion of the competent authorities" and not the Member States). The text of the Directive should be kept unchanged - **with the binding mutual recognition clause included in paragraph 16** - and the Member States that have not implemented this provision should be urged to do so.

3. **Drafting proposal**: The following wording could be added at the end of the current paragraph 15.

… Competent authorities shall draw up and make public the criteria used and/or the list of the public sector entities to be risk-weighted like central governments in the context of the supervisory disclosure framework referred to in Article 144 of this Directive.

27. Standardised approach, Annex VI, Part 1, Point 17 (Directive 2006/48/EC)

"When competent authorities of a third country jurisdiction, which apply supervisory and regulatory arrangements at least equivalent to those applied in the Community, treat exposures to its public sector entities as exposures to institutions, Member States may allow their credit institutions to risk weight exposures to such public sector entities in the same manner."

Objective of the discretion: More permissive treatment of exposures to public sector entities of third countries with supervisory/regulatory arrangements at least equivalent to those applied in the Community.

1. **Overview of exercise:** Currently 87% of Member States exercise the discretion, of which 10% with a proviso and 13% of Member States do not exercise the discretion.

2. **Reasoning and proposal**: The treatment of local PSEs in third countries requires local judgement as well as a case by case approach, and can be entrusted to the third country if it has equivalent standards of supervision. The proposal is to **transform the national discretion into a supervisory decision,** adding to it an **EU joint assessment process** to be carried out by all supervisors that wish to participate. If the supervisors reach a consensus view this could subsequently be adopted by competent authorities from all Member States. This proposal will promote convergence and will also alleviate the burden of the assessment. Feedback received in the public consultation indicates that market participants welcome the joint assessment process, but also that they would like the outcome of this assessment to be binding to all supervisors. CEBS believes that this would result in a fundamental change to the existing allocation of tasks between CEBS and supervisors and more generally to the current supervisory framework. Such a change falls outside

the mandate given by the European Commission and cannot thus be recommended by CEBS. CEBS also points out that the positive experience with the joint ECAI recognition process leads to the conclusion that the established process has positive consequences for the level of harmonisation. Additionally, the fall back option for third countries which are not deemed equivalent is the general rule in paragraph 13.

3. **Drafting proposal**:

When competent authorities of a third country jurisdiction, which apply supervisory and regulatory arrangements at least equivalent to those applied in the Community, treat exposures to its public sector entities as exposures to institutions, competent authorities may allow their credit institutions to risk weight exposures to such public sector entities in the same manner.

When the supervisory and regulatory arrangements of a third country need to be evaluated, all relevant competent authorities in the EU shall be invited to participate in a joint assessment. When, as a result of the joint assessment, a competent authority of one Member State subsequently allows their credit institutions to treat exposures to third country public sector entities as exposures to the third country institutions, competent authorities of another Member State may also allow their credit institutions to do this without conducting their own assessment.

28. Standardised approach, Annex VI, Part 1, Point 37 (Directive 2006/48/EC)

"Exposures to institutions of a residual maturity of 3 months or less denominated and funded in the national currency may, subject to the discretion of the competent authority, be assigned, under both methods described in points 26 to 27 and 29 to 32, a risk weight that is one category less favourable than the preferential risk weight, as described in points 4 and 5, assigned to exposures to its central government."

Objective of the discretion: More permissive treatment of short term exposures to Member States' institutions.

1. **Overview of exercise:** Currently 67% of Member States exercise the discretion, 3% of which with a proviso and 33% of Member States do not exercise the discretion.

2. **Reasoning and proposal**: Stakeholders are split on the importance of the impact of the divergent exercise of this national discretion. The negative aspects of this provision can be alleviated by allowing this favourable treatment - for short term exposures in its national currency to institutions - to all credit institutions. CEBS's proposal is to **delete the discretionary part of the provision**. The word 'may' in the Directive should replaced by 'shall' and the Member States that have not yet implemented this provision should be urged to do so. However, some Members argued that the preferred treatment of exposures which are denominated and funded in the same

currency is risk adequate for exposures assigned to the exposure class 'central governments or central banks' (Annex VI part I points 4 and 5), but not for exposures assigned to the exposure class 'institutions which may not be able to pay their obligations'. Therefore, the diminution of risk weights for long term obligations from 50%, 100% or 150% to at least 20% in the last three months may not be prudent.

3. **Drafting proposal:**

Exposures to institutions of a residual maturity of 3 months or less denominated and funded in the national currency shall be assigned, under both methods described in points 26 to 27 and 29 to 32, a risk weight that is one category less favourable than the preferential risk weight, as described in points 4 and 5, assigned to exposures to their central government.

29. Standardised approach, Annex VI, Part 1, Point 40 (Directive 2006/48/EC)

"Where an exposure to an institution is in the form of minimum reserves required by the ECB or by the central bank of a Member State to be held by a credit institution, Member States may permit the assignment of the risk weight that would be assigned to exposures to the central bank of the Member State in question provided: (…)"

Objective of the discretion: More permissive treatment of exposures in the form of minimum reserves required by the ECB or by the central bank if certain conditions are met.

1. **Overview of exercise:** Currently 70% of Member States exercise the discretion and 30% of Member States do not exercise the discretion.

2. **Reasoning and proposal**: Stakeholders are split on the importance of the impact of the differing exercise of this national discretion. The negative aspects of this provision can be alleviated by allowing this favourable treatment to all credit institutions. The set of criteria that must be met before an institution could use this more permissive treatment appear adequate, which means that adherence to the criteria should be left to the institution that wants to make use of the more favourable treatment (this can subsequently be challenged by the supervisor in the course of normal supervision.) For the sake of clarity the proposal is to **delete the discretionary part of this national discretion turning it into an option for credit institutions,** provided the conditions set are met.

3. **Drafting proposal:**

Exposures to an institution in the form of minimum reserves required by the ECB or by the central bank of a Member State to be held by a credit institution may be risk-weighted as exposures to the central bank of the Member State in question provided that the following conditions are met:

[…] and

[…] ".

30. Standardised approach, Annex VI, Part 1, Point 63 (Directive 2006/48/EC)

"Nonetheless, where a past due item is fully secured by forms of collateral other than those eligible for credit risk mitigation purposes, a 100 % risk weight may be assigned subject to the discretion of competent authorities based upon strict operational criteria to ensure the good quality of collateral when value adjustments reach 15% of the exposure gross of value adjustments."

Objective of the discretion: More permissive treatment of past due exposures under conditions.

1. **Overview of exercise:** Currently 17% of Member States exercise the discretion and 83% of Member States do not exercise the discretion.

2. **Reasoning and proposal**: Stakeholders are split on the importance of the impact of the divergent exercise of this national discretion. This national discretion is currently applied in line with the market specificities and business practices of each country, but it hampers the level playing field and the risk of the exposures appears not to be fully in line with the more favourable treatment. **Deleting the provision** is preferable and possible. However, it is important to allow a **transitional period of 10 years** in order to help the countries with local market specificities gradually change their market practices. A lengthy transition period is quite common in such cases (for example, the proposal for hybrid capital instruments to be eligible as original own funds for 30 years, or article 154 2006/48/EC which allows certain equity exposures to be exempted from the IRB treatment for a 10 year period).

3. **Drafting proposal:**

Nonetheless, until 31 December 2019, where a past due item is fully secured by forms of collateral other then those eligible for credit risk mitigation purposes, a 100 % risk weight may be assigned subject to the discretion of competent authorities based upon strict operational criteria to ensure the good quality of the collateral when value adjustments reach 15 % of the exposure gross of value adjustments.

31. Standardised approach, Annex VI Part 1 Point 64 (Directive 2006/48/EC)

"Exposures indicated in points 45 to 50 shall be assigned a risk weight of 100 % net of value adjustments if they are past due for more than 90 days. If value adjustments are no less than 20 % of the exposure gross of value adjustments,

the risk weight to be assigned to the remainder of the exposure may be reduced to 50 % at the discretion of competent authorities."

Objective of the discretion: This national discretion allows a more permissive treatment for past due exposures secured by mortgages on residential property. They can get a lower risk weighting if the conditions are met.

1. **Overview of exercise**: 67% of Member States have exercised this national discretion and 33 % state that they have not.

2. **Reasoning and proposal**: Stakeholders are split on the importance of the impact of the divergent exercise of this national discretion. Even though the majority of Member States have exercised this discretion, its prudence is questionable. According to the text, this provision could be perceived as a supervisory decision to be applied on a case by case basis that should have been implemented by all Member States (the provision says "at the discretion of the competent authorities" and not of the Member States). However, as the subject matter is mortgages on residential property, this is either a local market circumstance (for which binding mutual recognition is appropriate) or a provision which may no longer be appropriate from a risk perspective.

   CEBS invited market participants to provide input during the consultation period on the costs and benefits of the two options it has considered: keeping the discretion (with added binding mutual recognition implicit in the criteria to be fulfilled) or removing the provision from the CRD. Market participants unanimously objected to the deletion of this national discretion. They argue that value adjustments of at least 20% and the existence of collateral that fully secures the nominal amount of the outstanding loan facility are strong safeguards that clearly lower the exposure at risk and justify lower risk weights. In addition, residential properties in well developed markets can be accurately valued allowing a detailed calculation of the proceeds from forced sale procedures. Taking into account both the feedback received from the industry and the fact that two thirds of Member States have implemented this discretion, CEBS has a slight preference to **keep the discretion (with added binding mutual recognition implicit in the text of the ND).** However, CEBS notes that some of it members strongly question the prudence of the treatment allowed by this discretion and as a fall back option CEBS would not object to the removal of the provision from the CRD with a short transitional period.

3. **Drafting proposal:**

   Exposures indicated in points 45 to 50 shall be assigned a risk weight of 100 % net of value adjustments if they are past due for more than 90 days. If value adjustments are no less than 20 % of the exposure gross of value adjustments, the risk weight to be assigned to the remainder of the exposure may be reduced to 50 % at the discretion of the competent authorities of the Member State in which the residential property is located.

4. **Other remarks:** Competent authorities should fully disclose the manner of their exercise of this national discretion in the supervisory disclosure framework if they do not do so already.

32. Standardised approach, Annex VI Part 1 Point 66 (Directive 2006/48/EC)

"Subject to the discretion of competent authorities, exposures associated with particularly high risks such as investments in venture capital firms and private equity investments shall be assigned a risk weight of 150 %."

Objective of the discretion: The national discretion allows a more restrictive treatment for risk weighting items included in regulatory high risk categories.

1. **Overview of exercise**: 73 % of Member States have exercised this national discretion, 3% of which with a proviso and 27 % of Member States state that they have not.

2. **Reasoning and proposal**: Most stakeholders consider that the differing exercise of this national discretion has no or limited impact. The solution may be **to keep the discretion in the present form** to allow competent authorities the necessary flexibility they need to address "high risk" investments and crisis situations. Though this discretion is a supervisory decision (it says "subject to the discretion of competent authorities"), it can and should be applied on a flexible basis and should be applied across the board to address the various high risk exposures which may come up in a developing market. As it is applied across the board it does qualify as a national discretion.

3. **Drafting proposal:** No change is necessary at the CRD level, but the provision should be implemented as a supervisory decision to be applied across the board at the national level.

4. **Other remarks**: To enhance the transparency of the application of this discretion, the criteria to assess "high risk" investments or even a list of such investments could be included by each competent authority in the supervisory disclosure framework.

33. Standardised approach, Annex VI Part 1 Point 67 (Directive 2006/48/EC)

"Competent authorities may permit non past due items to be assigned a 150 % risk weight according to the provisions of this Part and for which value adjustments have been established to be assigned a risk weight of:

a) 100 %, if value adjustments are no less than 20 % of the exposure value gross of value adjustments; and

b) 50 %, if value adjustments are no less than 50 % of the exposure value gross of value adjustments"

Objective of the discretion: This national discretion allows a more permissive treatment of the regulatory high risk categories, which may get lower risk weights due to value adjustments.

1. **Overview of exercise**: 60% of Member States have exercised this national discretion, 6% of which with a proviso and 40 % of Member States state that they have not.

2. **Reasoning and proposal:** Stakeholders are split on the importance of the impact of the divergent exercise of this discretion. Though the national discretion is phrased like a supervisory decision, it can only be used across the board, and thus qualifies as a national discretion. CEBS has put forward for consultation its tentative assessment that the more favourable treatment allowed by this discretion is not justified and that the provision should be removed from the CRD with an appropriate short transitional period. CEBS invited market participants to comment on its tentative proposal and, if this was the case, to provide additional information to justify the more favourable treatment allowed by the discretion. Most respondents objected to the deletion of this national discretion, arguing that it is expedient to give financial institutions positive incentives to set up provision reserves for possible future losses and that the risk provisioning measures effectively lower the risk of the exposure. However CEBS notes divergent views among respondents and remains less than convinced with the arguments put forward on the need to keep the discretion. CEBS also notes that the prudence of the treatment allowed by the discretion is questionable. Since CEBS does not see a strong need to ensure consistent treatment with discretion 31 the proposal is therefore to **remove the provision from the CRD with a short transitional period.**

3. **Drafting proposal:**

Until 31 December 2014, competent authorities may permit non past due items to be assigned a 150 % risk weight according to the provisions of this Part and for which value adjustments have been established to be assigned a risk weight of:

a) 100 %, if value adjustments are no less than 20 % of the exposure value gross of value adjustments; and

b) 50 %, if value adjustments are no less than 50 % of the exposure value gross of value adjustments

34. Standardised approach, Annex VI Part 1 Point 68 (e) (Directive 2006/48/EC)

"(…) The competent authorities may recognise loans secured by commercial real estate as eligible where the Loan to Value ratio of 60 % is exceeded up to a maximum level of 70 % if the value of the total assets pledged as collateral for the covered bonds exceed the nominal amount outstanding on the covered

bond by at least 10 %, and the bondholders' claim meets the legal certainty requirements set out in Annex VIII (...)"

Objective of the discretion: This national discretion allows a more permissive treatment for loans secured by commercial real estate as collateral for covered bonds.

1. **Overview of exercise**: 43 % of Member States have exercised this national discretion and 57 % state that they have not.

2. **Reasoning and proposal:** The majority of Members do not exercise the option and are indifferent to this discretion. On the one hand, this provision allows for a less prudent treatment since it opens the possibility of using a higher loan-to-value ratio and is therefore considered by some Member States not to be prudent. On the other hand, for some Members the option is very important as removing it (even with a long transitional period) would have a serious impact on their economy. The level playing field considerations here are outweighed by the cost and impact in the Member States where it would be abolished. At the technical level the proposal is **to keep this national discretion in the present form**.

3. **Drafting proposal**: No change necessary.

4. **Other remarks**: To expand on the reasons for this, using the example of one of the Member States for which it is very important. This member argues that the domestic legal framework permits higher LTVs but ensures a similar level of prudence by requiring compulsory over-collateralisation and sound and prudent valuation criteria (sustainable value). Therefore, these assets have specific characteristics which ensure that they have the necessary quality to be included in the list of eligible assets to collateralize "covered bonds". In addition if this national discretion is eliminated, it would have a substantial effect on their market for covered bonds, and a high impact on the banks issuing them. If a change is made, there would not be any covered bonds collateralised by loans secured by real estate because, following the domestic law, the whole real estate portfolio collateralises the covered bond and it is not possible to segregate the portfolio depending on LTV levels . It is noted that though it is possible that the law could change in the future, this is not an issue to be determined by banking supervisors. Also, in this case, it is important to point out that the current loans secured by commercial real estate used as collateral for covered bonds have a maturity of 20 years on average which should be taken into account in such a non-technical decision.

35. Standardised approach, Annex VI Part 1 Point 85 (Directive 2006/48/EC)

"Member States may allow a risk weight of 10 % for exposures to institutions specialising in the inter-bank and public-debt markets in their home Member States and subject to close supervision by the competent authorities where those asset items are fully and completely secured, to the satisfaction of the competent authorities of the home Member States, by a items assigned a 0 %

or a 20 % risk weight and recognised by the latter as constituting adequate collateral."

Objective of the discretion: This national discretion allows a more permissive treatment for the risk weighting of institutions specialising in the inter-bank and public debt markets.

1. **Overview of exercise**: 23 % of Member States have exercised this national discretion and 77 % state that they have not.

2. **Reasoning and proposal**: Upon further analysis, the national discretion was not considered to be important by any of the Members and its exercise could lead to market distortions. As the benefits of removing it, in line with industry proposals, outweigh any use being made of it, there is no obstacle to removing the national discretion from the CRD. The proposal is to **delete the provision** from the CRD.

3. **Drafting proposal**: Delete Annex VI Part 1 Point 85 of Directive 2006/48/EC.

36. Standardised approach, Annex VI Part 3 Point 17 (Directive 2006/48/EC)

"Notwithstanding point 16, when an exposure arises through a credit institution's participation in a loan that has been extended by a Multilateral Development Bank whose preferred creditor status is recognised in the market, competent authorities may allow the credit assessment on the obligors' domestic currency item to be used for risk weighting purposes."

Objective of the discretion: This national discretion allows a more permissive treatment. It allows the use of domestic currency ratings for foreign currency exposures.

1. **Overview of exercise**: 77 % of Member States have exercised this national discretion and 23 % state that they have not.

2. **Reasoning and proposal**: The differing exercise of the provision has limited impact, but positively impacts on the approach to multilateral development banks (MDBs). Since there are benefits in a uniform treatment across the EU and this national discretion has a limited scope with limited impact on the total capital requirement, the proposal is to **delete the discretionary part of the provision turning it into an option for credit institutions** as this seems both prudent (such lending has low risk) and the most efficient solution.

3. **Drafting proposal:**

Notwithstanding point 16, when an exposure arises through a credit institution's participation in a loan that has been extended by a Multilateral Development Bank whose preferred creditor status is recognised in the

market, the credit assessment on the obligors' domestic currency item may be used for risk weighting purposes.

Area: IRB

37. IRB, Article 84.2. (Directive 2006/48/EC)

"Where an EU parent credit institution and its subsidiaries or an EU parent financial holding company and its subsidiaries use the IRB Approach on a unified basis, the competent authorities may allow minimum requirements of Annex VII, Part 4 to be met by the parent and its subsidiaries considered together."

Objective of the discretion: The objective is to consider the group as a whole as regards the IRB requirements. It goes in the direction of a less restrictive approach.

1. **Overview of exercise**: 83% of Member States exercise this discretion, 13% of which with a proviso and 17% do not exercise it.

2. **Reasoning and proposal**: This national discretion is considered to be quite important though the impact of its differing exercise is considered to be limited in general (although for cross border groups it could be high). This option may be exercised by supervisors on a case by case basis in the context of the **supervisory approval process** of IRB models since it closely reflects the structure of the specific banking group and the way it is organised as regards risk management processes and methodologies. In fact in CEBS's opinion this provision **is not intended to be a national discretion, but a supervisory decision** to be applied on a case by case basis that should have been implemented by all Member States. It should also be applied as such. The text of the Directive should be kept unchanged and the Member States that have not yet implemented this provision as a supervisory decision to be used on a case by case basis should be urged to do so as soon as possible.

3. **Drafting proposal:** No change necessary at the CRD level, but the provision should be implemented as a supervisory decision at the national level.

38. IRB, Annex VII, Part. 1, Point 6 (Directive 2006/48/EC)

"The Competent Authorities may authorise a credit institution generally to assign preferential risk weights of 50% to exposures in category 1, and a 70% risk weight to exposures in category 2, provided the credit institution's underwriting characteristics and other risk characteristics are substantially strong for the relevant category."

Objective of the discretion: Subject to certain conditions, it allows more favourable risk weights for SL exposures.

1. **Overview of exercise:** 73% of Member States have exercised this national discretion, 7% of which with a proviso and 27% have not exercised it.

2. **Reasoning and proposal:** The discretion is not considered very important in general, but its impact on the level playing field for project finance business is likely to be rather more important given the international nature of the business and its players. A particular issue is the level playing field with the USA; a change from the text set out in the Basel II proposals on this issue would have a significant impact on markets and the level playing field, and so should be considered only at a worldwide level. Given that the majority of Member States have implemented this national discretion in their national rules, CEBS has considered whether to transform it into a option for institutions (obviously, the supervisory assessment would be part of the more general IRB approval process) but has rejected that solution because the criteria for assigning the preferential risk weights are not objective and respondents to the consultation were unable to provide CEBS with more objective criteria. For level playing field reasons some market participants suggested that competent authorities should develop common criteria or a common understanding on the criteria. CEBS's proposal is, therefore, to **implement the provision as a supervisory decision which is part of the approval process**. As such, it should be applied on a case by case basis and should have been implemented as such by all Member States (the provision says "Competent authorities may authorise" and not the Member States). The text of the Directive should be kept unchanged and the Member States that have not implemented this provision should be urged to do so. CEBS will request its Members to disclose any criteria used in the supervisory disclosure framework, which may lead to future follow-up work if a consensus is reached.

3. **Drafting proposal:** No change is necessary at this stage at the CRD level, but the provision should be implemented as a supervisory decision at the national level within the scope of the approval process.

39. IRB, Annex VII, Part. 1, Point 13 (last sentence) (Directive 2006/48/EC)

"By way of derogation from point (b), competent authorities may waive the requirement that the exposure be unsecured in respect of collateralised credit facilities linked to a wage account."

Objective of the discretion: The discretion is rooted in local market specificities and reflects a common practice in several Member States.

1. **Overview of exercise:** 70% of Member States have exercised this national discretion.

2. **Reasoning and proposal:** This discretion seems to be relevant only for some countries although feedback from market participants states that this provision is very significant for providers of consumer credit. According to the CRD text, this provision should be a supervisory decision to be applied on

a case by case basis that should have been implemented by all Member States (the provision says "the competent authorities may waive" and not the Member States). However, in practice, where exercised this discretion can only be applied across the board which means that in substance it is a national discretion. As the subject matter is collateral linked to wage accounts this discretion relates to local market conditions for which binding mutual recognition is appropriate. Additionally the discretion relates to national laws other than banking laws and reflects a common practice in several Member States. As a result, the proposal is to **keep the national discretion with added binding mutual recognition**.

3. **Drafting proposal:** Add to the CRD provision a binding mutual recognition clause.

(…) When by way of derogation from point (b) the requirement is waived by the competent authorities of the Member State where the wage account is located, the competent authorities of another Member State shall also allow institutions to disregard the requirement in respect of those wage accounts.

40. IRB, Annex VII, Part 1, Point 18 (Directive 2006/48/EC)

"Notwithstanding point 17, competent authorities may allow the attribution of risk weighted exposure amounts for equity exposures to ancillary services undertakings according to the treatment of other non credit- obligation assets."

Objective of the discretion: Given the IRB treatment of equity exposures, the capital effect of this rule would certainly be to reduce the capital requirements (vis à vis a 100% RW).

1. **Overview of exercise:** 87% of Member States have exercised this national discretion.

2. **Reasoning and proposal:** The provision is not intended to be a national discretion, but a supervisory decision to be applied on a case by case basis that should have been implemented by all Member States. It should also be applied as such and the Member States that have not yet implemented this provision as a supervisory decision to be used on a case by case basis should be urged to do so as soon as possible. However, since this rule goes in the direction of avoiding an excessive burden for banks, given that the assignment of an internal rating to such exposures would be neither feasible nor economically meaningful, the proposal is to **delete the discretionary part of the provision turning it into an option for credit institutions.**

3. **Drafting proposal**:

Notwithstanding point 17, risk weighted exposure amounts for equity exposures to ancillary services undertakings may be treated according to the treatment of other non credit-obligation assets.

41. IRB, Annex VII, Part. 2, Point 5 and 7 & Annex VIII, Part 1, Point 26 (Directive 2006/48/EC)

Point 5, second sentence: "(…) For dilution risk, however, competent authorities may recognise as eligible unfunded credit protection providers other than those indicated in Annex VIII, Part 1."

Point 7, fourth sentence: "(…) Competent authorities may recognise as eligible unfunded credit protection providers other than those indicated in Annex VIII, Part 1. (…)"

Point 26: "The following parties may be recognised as eligible providers of unfunded credit protection: (…)"

Objective of the discretion: More favourable treatment.

1. **Overview of exercise:** 43% of Member States have exercised this national discretion, 3% of which with a proviso.

2. **Reasoning and proposal:** In the absence of a clear indication of the importance and impact of the deletion of this provision CEBS initially considered, tentatively, that this national discretion could be deleted. Following its request, however, respondents indicated that this national discretion is important. The feedback received from the public consultation shows a preference for keeping the national discretion with the introduction of a mutual recognition clause. As personal guarantees may differ between Member States, respondents believe the right approach is to leave the initial judgement to the home authority, i.e. to maintain this provision, but to combine it with binding mutual recognition so that institutions in other Member States could benefit from guarantees from the same protection provider. In addition some respondents believe that the possibility of recognising unfunded protection providers, subject to certain conditions, is important due to the continued evolution of the contract structures of personal guarantees. This provision has a significant impact on, in particular, the factoring business. Taking into account the feedback received CEBS's proposal is to **keep the national discretion with the introduction of a binding mutual recognition clause.**

3. **Drafting proposal:** Addition of a binding mutual recognition clause.

When this national discretion is exercised by the competent authorities of one Member State, the competent authorities of another Member State shall allow their institutions also to use as eligible unfunded credit protection providers those recognised by that competent authority.

42. IRB, Annex VII, Part. 2, Point 12 and 13 (Directive 2006/48/EC)

Point 12, last sentence: "(…) Competent Authorities may require all credit institutions in their jurisdiction to use maturity (M) for each exposure as set out under point 13." (i.e. in accordance with formulae instead of using values by default (0.5 years for repos and 2.5 for other exposures).

Objective of the discretion: It goes in the direction of a more risk-sensitive (and more burdensome) measurement of M in the FIRB approach.

1. **Overview of exercise:** 36% of Member States have implemented this national discretion, 3% of which with a proviso.

2. **Reasoning and proposal:** There are a variety of different approaches among Members and it was not possible, at this stage, to reach a consensus on this national discretion. On one hand, it does not seem sensible to delete the provision since it goes in the direction of a more risk-sensitive approach; on the other hand, it seems difficult to delete the discretionary part of the provision since only a minority of Member States have implemented it and seem to be applying it in a proportionate way. The proposal is thus to **keep the national discretion as it is.**

3. **Drafting proposal:** No change necessary.

43. IRB, Annex VII, Part. 2, Point 15, first sentence (Directive 2006/48/EC)

"The competent authorities may allow for exposures to corporates situated in the Community and having consolidated sales and consolidated assets of less than EUR 500 million the use of M as set out in point 12. (…)"

Objective of the discretion: Allows a less risk sensitive approach.

1. **Overview of exercise:** 30% of Member States have exercised this national discretion.

2. **Reasoning and proposal:** This ND was analysed together with ND 44. Both allow competent authorities to specify a flat maturity of 2.5 years when supervisory LGDs are used ("foundation approach") and, for the most part, when own estimates for LGD are used beyond retail ("advanced approach"). There are different considerations and split views on these discretions both from the industry and regulatory perspectives with the mirror industry working group unable to reach a consensus on these discretions.

   Two jurisdictions (Germany and Austria) consider that these discretions are essential. They argue that the maturity factor b in annex VII, part 1, para 3 generates excessively high maturity adjustments. This implies capital requirements which are too low for exposures with a short maturity and too high for exposures with a long maturity. They think it likely that this will result in the replacement of long term lending to SME´s and housing associations with short term lending, instead of issuing long term bonds or equity. Long-term SME financing is a very important issue for these jurisdictions, even though this type of lending is not very common in other Member States. These Member States emphasize that in their cases long-term SME financing has a long tradition and has passed the test of time and if these Member States were no longer allowed to apply a flat maturity of 2.5 years this could seriously damage their economies.

3. However, most CEBS Members believe that, from a prudential perspective, it is not obvious why this type of lending should be treated differently from other long-term lending under the Advanced IRB Approach. In fact, they believe that the Advanced IRB Approach provides appropriate risk weights for different maturities and that the national discretions in question provide artificial subsidies for long-term financing of a specific sector by the institutions from the countries involved. If SME exposures are of low risk, this would be adequately reflected in the IRB model, i.e. the outcome would be a low risk weight based on the data. Moreover, they believe if subsidising specific types of lending is required, this could be achieved by other means than by prudential requirements which are supposed to adequately reflect levels of risk and nothing else. The existence of these discretions also disturbs the level playing field in the EU. Therefore, it is proposed **to remove the provision from the CRD with a transitional period of 10 years and grandfathering clauses.**

4. **Drafting proposal:**

Until 31 December 2019, the competent authorities of a Member State may allow for exposures of an institution to corporates situated in the Community and having consolidated sales and consolidated assets of less than EUR 500 million the use of M as set out in point 12. After the expiry of this clause, commitments already given for such exposures may continue to be treated in this way to the extent drawn before this date.

5. **Other remarks:** The CEBS's technical advice is to delete the provisions. If this advice is not followed, levelling the playing field for EU banks should be considered. This could be done by allowing all EU institutions the option of using this exemption if they provide financing to housing associations or SMEs from Member States implementing this ND, though this would export the less risk sensitive treatment to other Member States. CEBS also notes that it mainly received input from housing associations in the relevant Member States. SMEs did not raise the issue themselves.

44. IRB, Annex VII, Part. 2, Point 15, last sentence (Directive 2006/48/EC)

"(…) Competent authorities may replace EUR 500 million total assets with EUR 1000 million total assets for corporates which primarily invest in real estate."

Objective of the discretion: Same as previous national discretion.

1. **Overview of exercise:** 17% of Member States have exercised this national discretion.

2. **Reasoning and proposal:** As in substance this national discretion is similar to discretion 43 the reasoning is the same. Supervisory authorities in two Member States (Germany and Austria) indicate that this ND should be kept. However, the proposal is **to remove the provision from the CRD with a long transitional period of 10 years and grandfathering clauses.**

3. **Drafting proposal:**

Until 31 December 2019, competent authorities of a Member State may replace EUR 500 million total assets with EUR 1000 million total assets for corporates in the Member State which primarily invest in real estate. After the expiry of this clause, commitments already given for such exposures may continue to be treated in this way to the extent drawn before this date.

45. IRB, Annex VII, Part. 2, Point 20 & Annex VIII Part 1, Point 26 (Directive 2006/48/EC)

Point 20: "Unfunded credit protection may be recognised as eligible by adjusting PDs subject to point 22. For dilution risk, where credit institutions do not use own estimates of LGD, this shall be subject to compliance with articles 90 to 93; for this purpose, competent authorities may recognise as eligible unfunded protection providers other than those indicated in Annex VIII, Part 1."

Objective of the discretion: The objective of the discretion, when applied, is to recognise other providers for dilution risk. The discretion will reduce capital requirements and so goes in the direction of a more permissive approach.

1. **Overview of exercise**: 40% of Member States have applied this discretion and 60% have not applied it.

2. **Reasoning and proposal:** This national discretion was analysed in conjunction with national discretion number 41. In general, stakeholders do not expect an impact from the divergent exercise of this discretion. Since protection providers for dilution risk should meet the same eligibility criteria as for default risk and that the exercise of the national discretion can create level playing field problems among institutions operating in the same market, CEBS has considered deleting the provision from the CRD. However, feedback received in the course of public consultation shows a preference for keeping the national discretion with the introduction of a mutual recognition clause. As personal guarantees may differ between Member States, respondents believe the appropriate approach is to leave the initial judgement to the home authority, i.e. to maintain this provision, but to combine it with binding mutual recognition so that institutions in other Member States could benefit from guarantees from the same protection provider. In addition, some respondents believe that the possibility of recognising unfunded protection providers, subject to certain conditions, is important due to the continued evolution of the contract structures of personal guarantees. This provision has a significant impact in particular on the factoring business. Based on this feedback, CEBS's proposal is to **keep the national discretion with the introduction of a binding mutual recognition clause.**

3. **Drafting proposal:** Add a binding mutual recognition clause.

When this national discretion is exercised by the competent authorities of a Member State, the competent authorities of another Member State shall

allow their institutions also to use as eligible unfunded credit protection providers those recognised by that competent authority.

46. IRB, Annex VII, Part. 4, Point 56 (Directive 2006/48/EC)

"If credit institutions can demonstrate to their competent authorities that for data that have been collected prior to the date of implementation of this Directive appropriate adjustments have been made to achieve broad equivalence with the definition of default or loss, competent authorities may allow the credit institutions some flexibility in the application of the required standards for data."

Objective of the discretion: The objective of the discretion, when applied, is to allow institutions to use past data (i.e. collected prior to the implementation date of Basel II) which do not fully comply with the requirements set out in the Directive, i.e. helping institutions to implement IRB approaches.

1. **Overview of exercise:** 93% of Member States are exercising this discretion, 10% of which are exercising it with a proviso and 7% do not apply it.

2. **Reasoning and proposal:** Most stakeholders do not expect material impacts from the divergent exercise of this discretion. In addition, as time goes by and banks collect more recent data for their time series, the relevance of data collected prior to implementation date is expected to decrease. Given that a large majority of Member States have adopted this discretion, it is proposed to retain this discretion until 2014. This timescale is consistent with the data requirements framework for calculating PDs and LGDs. In fact this provision **is not intended to be a national discretion, but a supervisory decision** (the provision says "competent authorities may allow" and not the Member States) to be applied on a case by case basis (i.e. **within the IRB approval process**) that should have been implemented by all Member States. It should also be applied as such. The text from the Directive should be kept unchanged and the Member States that have not yet implemented this provision as a supervisory decision to be used on a case by case basis should be urged to do so as soon as possible.

3. **Drafting proposal:** No change necessary at the CRD level, but the provision should be implemented as a supervisory decision at the national level.

Area: CRM

47. CRM, Annex VIII, Part 1, Point 15 (Directive 2006/48/EC)

"The competent authorities may also authorise their credit institutions to recognise as eligible collateral shares in Finnish housing companies operating in accordance with the Finnish Housing Company Act of 1991 or subsequent

equivalent legislation as commercial real estate collateral, provided that these conditions are met"

Objective of the discretion: The objective of this national discretion is to recognise a particular market.

1. **Overview of exercise**: 43% of Member States have applied this discretion, 57% have not.

2. **Reasoning and proposal**: The national discretion has a low impact, but it is used in one Member State extensively and has a clear benefit there. The costs of maintaining the provision could be reduced by levelling the playing field. If kept, it should be available to all credit institutions doing business with these clients at their own discretion. This would not raise significant prudential concerns. It is, therefore, proposed to transform it into an **option for credit institutions**. Although equivalent structures exist in other Member States these are considered to be out of the scope of CEBS's work.

3. **Drafting proposal:**

Credit institutions may use as eligible collateral shares in Finnish housing companies operating in accordance with the Finnish Housing Company Act of 1991 or subsequent equivalent legislation as commercial real estate collateral, provided that these conditions are met.

4. **Other remarks**: To expand on the reasons behind the proposal, housing companies are a typical housing system in Finland; the shares in a housing company give their owner the right of possession of a specific apartment. The shares are treated as personal property and can be sold and used as collateral for a loan. The owners pay a monthly fee to the housing company to cover maintenance costs, heating costs and the water supply. The maintenance charge can also be used for renovations and modernizations aimed at making the real estate and building meet current requirements. Housing companies' policies are defined by owners in shareholders meetings. The board of the housing company is elected at the shareholders meeting. The board sees to the management of the housing company. From the collateral point of view the shares are regarded as good collateral because housing in Finland is generally new or recent and of a good quality. The housing company is normally taking good care of the building, real estate and apartments. The housing market in Finland is effective and functional. The shares are considered to be as good collateral as residential real estate. Even in the recession years Finnish banks have very rarely experienced losses from housing loans, partly due to the good quality of the collateral.

48. CRM, Annex VIII, Part 1, Point 20 (Directive 2006/48/EC)

"The competent authorities may recognise as eligible collateral amounts receivable linked to a commercial transaction or transactions with an original maturity of less than or equal to one year. Eligible receivables do not include

those associated with securitisations, sub-participations or credit derivatives or amounts owed by affiliated parties."

Objective of the discretion: This national discretion allows a more permissive treatment recognising a wider range of collateral.

1. **Overview of exercise:** 93% of Member States are exercising this discretion, 3% of which are exercising it with a proviso and 7% do not apply it.

2. **Reasoning and proposal**: In general, stakeholders do not perceive a material impact of the divergent exercise of the discretion, but some expect level playing field problems. This provision is not intended to be a national discretion, but a supervisory decision (the provision says "competent authorities may recognise" and not the Member States) to be applied on a case by case basis that should have been implemented by all Member States. It should also be applied as such. In principle, the text from the Directive could be kept unchanged and the Member States that have not yet implemented this provision as a discretion to be used on a case by case basis should be urged to do so as soon as possible. However, this seems to be an area where convergence would be possible through the **deletion of the discretionary part of the provision**. Nevertheless, it is noted that, due to its specific market conditions and legal environment, one of the two Members currently not exercing the discretion (Poland) considers receivables to be very poor collateral and very sensitive to the economic cycle and therefore not suitable to be recognized as eligible collateral. As a result, Poland opposes having to recognise this type of collateral in the future.

3. **Drafting proposal:**

Amounts receivable linked to a commercial transaction or transactions with an original maturity of less than or equal to one year are eligible as collateral. Eligible receivables do not include those associated with securitisations, sub-participations or credit derivatives or amounts owed by affiliated parties.

49. CRM, Annex VIII, Part 1, Point 21 (Directive 2006/48/EC)

"The competent authorities may recognise as eligible collateral physical items of a type other than those types indicated in points 13 to 19 if satisfied as to the following: (a) liquid markets for disposal of the collateral do exist in an expeditious and economically efficient manner; and (b) well-established, publicly available market prices for the collateral do exist. The institution must be able to demonstrate that there is no evidence that the net prices it receives when collateral is realised deviates significantly from these market prices."

Objective of the discretion: The competent authorities may recognise as eligible collateral physical items of a type other than real estate collateral. This national discretion allows a more permissive treatment recognising a wider range of collateral.

1. **Overview of exercise:** 83% of Member States are exercising this discretion, 7% of which are exercising it with a proviso and 17% do not apply it.

2. **Reasoning and proposal**: The analysis shows that the provision is quite important in a few Member States. On the one hand, there would be a significant impact from deleting the provision, while, on the other hand, it is not relevant elsewhere, and it would be less prudent to introduce it across the board. It should be noted that representatives from the leasing industry stressed in their response to the consultation that the recognition of other (i.e. non real estate) physical collateral under the CRD is one of the most important issues for the European leasing industry. The cost of keeping the national discretion can be adequately compensated by adding mutual recognition. The proposed solution is, therefore, **to keep the national discretion as it is** but add a **non-binding mutual recognition clause**. Where the collateral is local, and recognized due to local market conditions, other supervisors will be expected to take on board the local supervisors' judgement. As this article can also apply to collateral which is not specific to the local market, but also to collateral in other Member States and in third countries (e.g. in the case of moveable assets), binding mutual recognition cannot be proposed here.

3. **Drafting proposal**:

The Competent Authorities may recognise as eligible collateral physical items of a *type other than* those types indicated in points 13 to 19*, if satisfied as to the following: (a) liquid markets for disposal of the collateral in an expeditious and economically efficient manner do exist; and (b) well-established, publicly available market prices for the collateral do exist. The institution must be able to demonstrate that there is no evidence that the net prices it receives when collateral is realised deviates significantly from these market prices. Either the criteria used or the list of physical items recognised as eligible collateral other than real estate shall be disclosed by each competent authority in the supervisory disclosure framework referred to in Article 144 of this Directive.*

When this discretion is exercised by the competent authorities of one Member State for a type of collateral, the competent authorities of another Member State may allow their credit institutions to recognise that collateral as eligible.

50. CRM, Annex VIII, Part 1, Point 28 (Directive 2006/48/EC)

"By way of derogation from point 26, the Member States may also recognise as eligible providers of unfunded credit protection, other financial institutions authorised and supervised by the competent authorities responsible for the authorisation and supervision of credit institutions and subject to prudential requirements equivalent to those applied to credit institutions."

Objective of the discretion: It goes in the direction of a less restrictive approach.

1. **Overview of exercise:** 43% of Member States have applied this discretion, 57% have not.

2. **Reasoning and proposal**: Additional eligible providers of unfunded credit protection can be added to the list in paragraph 26. However, those national discretions cover additional unidentified categories of eligible providers, while here the conditions are clear but require a local assessment of equivalence and supervision. If other institutions are equivalently supervised as credit institutions, there is no reason not to allow this, but their protection should be available to all credit institutions to prevent level playing field costs. The proposal is **to keep as it is but adding a binding mutual recognition clause**. Transparency and supervisory disclosure will be necessary.

3. **Drafting proposal:**

By way of derogation from point 26, the Member States may also recognise as eligible providers of unfunded credit protection, other financial institutions authorised and supervised by the competent authorities responsible for the authorisation and supervision of credit institutions and subject to prudential requirements equivalent to those applied to credit institutions. When this national discretion is exercised by the competent authorities of one Member State, the competent authorities of other Member States shall allow their institutions to recognise the same financial institutions as eligible providers of unfunded credit protection.

51. CRM, Annex VIII, Part 2, Point 9 (a) (ii) (Directive 2006/48/EC)

"For the recognition of receivables as collateral the following conditions shall be met: (a) Legal certainty: (…)

(ii) Credit institutions must take all steps necessary to fulfil local requirements in respect of the enforceability of security interest. There shall be a framework which allows the lender to have a first priority claim over the collateral subject to national discretion to allow such claims to be subject to the claims of preferential creditors provided for in legislative or implementing provisions"

Objective of the discretion: As an exception to the general rule – according to which a receivable can only be eligible as collateral if the lender has a first priority claim over it - Member States can recognize receivables as eligible collateral where the claim of the lender is subordinated to the claims of preferential creditors if these claims are recognized in the respective national insolvency law.

1. **Overview of exercise:** This option has been exercised by 73 % of Member States, of which 7% with a proviso while 17% of the Member States decided not to implement it.

2. **Reasoning and proposal:** The divergent exercise of this discretion is not perceived as problematic. Differences in insolvency legislation, in particular regarding what are considered to be preferential creditors' claims, as well as differences concerning the prudential adequacy of being less restrictive in this case, make it difficult to remove this option either by making it a general rule or by deleting it. The conditions, when it is needed, in domestic laws are clear and require a local assessment of the issues mentioned. If necessary it would also apply to institutions from other Member States which take such a local security interest. This protection should thus be available to all credit institutions operating in a given market to alleviate level playing field costs. As a result, it is proposed to **keep this national discretion in its present form with a non-binding mutual recognition clause.**

3. **Drafting proposal:**

Credit institutions must take all steps necessary to fulfil local requirements in respect of the enforceability of security interests. There shall be a framework which allows the lender to have a first priority claim over the collateral. Notwithstanding, and subject to national discretion, the claim of the lender over the collateral may be subject to the claims of preferential creditors provided for in legislative or implementing provisions. When this national discretion is exercised by the competent authorities of one Member State, the competent authorities of another Member State may allow their institutions to treat as a first priority claim a security interest in the Member State that has recognized it as such, subject to the previously mentioned preferential creditors' claims.

52. CRM. Annex VIII, Part 3, Point 12 (Directive 2006/48/EC)

"As an alternative to using the Supervisory volatility adjustments approach or the Own Estimates volatility adjustments approach in calculating the fully adjusted exposure value (E*) resulting from the application of an eligible master netting agreement covering repurchase transactions, securities or commodities lending or borrowing transactions, and/or other capital market driven transactions other than derivative transactions, credit institutions may be permitted to use an internal models approach (…). Subject to the approval of the competent authorities, credit institutions may also use their internal models for margin lending transactions, if the transactions are covered under a bilateral master netting agreement that meets the requirements set out in Annex III, Part 7".

Objective of the discretion: This provision allows for the use of the Internal Models approach, instead of the Supervisory volatility adjustments approach or the Own Estimates volatility adjustments approach, for the purpose of calculating the fully adjusted exposure value (E*) resulting from the application of an eligible master netting agreement covering certain types of transactions, subject to compliance with certain requirements. The internal models approach is a more sophisticated and risk sensitive approach and delivers, on average, lower capital requirements.

1. **Overview of exercise:** This provision has been implemented by all Member States, 13% of which with a proviso.

2. **Reasoning and proposal:** In fact , the possibility of using an internal model to calculate the fully adjusted exposure value resulting from the application of an eligible master netting agreement covering the transactions referred to is, in the current wording of the CRD, already an **option for credit institutions subject to the approval of the competent authority**. In particular, recognition by the competent authorities is based on the assessment of internal risk management systems, taking into account the standards set in paragraphs 16 to 18. In addition, the possibility of applying internal models for the recognition of the mitigating effects of margin lending transactions covered by bilateral master netting agreements should be interpreted as an option for credit institutions, subject to the approval of the competent authorities based on the verification of the criteria set in the CRD for the recognition of bilateral master netting agreements. Therefore, Member States that have not yet implemented this provision, in the terms explained, should be urged to do so as soon as possible.

3. **Drafting proposal:** The drafting proposal is presented to clarify the current wording of the CRD.

(…) *other capital market driven transactions other than derivative transactions, credit institutions may, subject to the recognition given by the competent authorities, use an internal models approach (…). Subject to the approval of the competent authorities, credit institutions may also use their internal models for margin lending transactions, if the transactions are covered under a bilateral master netting agreement that meets the requirements set out in Annex III, Part 7.*

53. CRM, Annex VIII, Part 3, Point 19 (Directive 2006/48/EC)

"The competent authorities may allow credit institutions to use empirical correlations within risk categories and across risk categories if they are satisfied that the credit institution's system for measuring correlations is sound and implemented with integrity."

Objective of the discretion: This provision is related to the use of the internal models approach for the purpose of calculating the fully adjusted exposure value (E*) resulting from the application of an eligible master netting agreements covering repurchase transactions, securities or commodities lending or borrowing transactions, and/or other capital market driven transactions (other than derivative transactions). The internal models approach must take into account correlation effects between security positions subject to the master netting agreement as well as the liquidity of the instruments concerned. This provision permits a more risk sensitive approach by allowing the use of empirical correlations within and across risk categories considered in the internal model used to estimate the fully adjusted exposure value.

1. **Overview of exercise:** 93% of Member States exercised this option, 10% of which with a proviso.

2. **Reasoning and proposal:** There is no or limited impact on business resulting from divergent exercise of the discretion. The implementation of this discretion requires individual decisions by the supervisors, which depend on institutions/business specificities. This provision is not intended to be a national discretion but a supervisory decision, in the form of the approval of the systems of an institution, to be applied on a case by case basis and should have been implemented by all Members in this way (the provision says "the competent authority may allow" and not the Member States). In principle, the text in the Directive should be kept unchanged and the Member States that have not yet implemented this provision should be urged to do so. In addition to the fact that 93% of Member States have implemented this permission, the positions expressed by the majority of the Members can be combined by giving firms the possibility of using empirical correlations within and across risk categories. The proposal is, therefore, to delete the discretionary element of the supervisory decision, making it effectively **an option for institutions** while noting that this choice for credit institution within the model is subject to the assessment by the supervisory authorities of institutions' systems for measuring correlations, as a component of the internal model approval process.

3. **Drafting proposal:**

Credit institutions may use empirical correlations within risk categories and across risk categories if the competent authorities are satisfied that their system for measuring correlations is sound and implemented with integrity.

54. CRM, Annex VIII, Part 3, Point 43 (Directive 2006/48/EC)

"When debt securities have a credit assessment from a recognised ECAI equivalent to investment grade or better, the Competent Authorities may allow credit institutions to calculate a volatility estimate for each category of security."

Objective of the discretion: This option is related to the application of the Financial Collateral Comprehensive Method used to calculate the mitigating effects of financial collateral. When valuing financial collateral 'volatility adjustments' shall be applied to the market value of collateral in order to take account of price volatility. Volatility adjustments may be calculated in two ways: the "Supervisory volatility adjustments approach" and the "Own estimates of volatility adjustments approach". This option is a simplifying provision which allows credit institutions to calculate a volatility estimate for each category of security (instead of calculating it for each security) when debt securities have a credit assessment from a recognised ECAI equivalent to investment grade or better. This option is intended to provide simplicity in the use of the Own estimates of volatility adjustments approach and is applicable to those institutions already complying with requirements set out in the CRD for the use of own estimates of volatility adjustments (which is not subject to authorisation).

1. **Overview of exercise:** This option has been exercised by 97% of Member States, 3% of which with a proviso.

2. **Reasoning and proposal:** This national discretion was analysed together with national discretion 53. There is no or limited impact on business resulting from divergent exercise of the discretion. The solutions proposed by the majority of the Member States were to remove the option by transforming it into a general rule or to give the option to the credit institutions (because they should be allowed to decide, based on their specificities, whether they wish to apply provisions with a beneficial effect, subject to conditions). As the provision allows for a less demanding approach (whose application is still subject to the fulfilment of the quantitative and qualitative criteria set out in the CRD), those two alternatives are similar in practical terms. The proposal is, therefore, to give the **option to the credit institutions.**

3. **Drafting proposal:**

When debt securities have a credit assessment from a recognised ECAI equivalent to investment grade or better, credit institutions may calculate a volatility estimate for each category of security.

55. CRM, Annex VIII, Part 3, Point 72 (Directive 2006/48/EC)

"By way of derogation, until 31 December 2012 the competent authorities may, subject to the levels of collateralisation indicated in Table 5: (a) allow credit institutions to assign a 30 % LGD for senior exposures in the form of Commercial Real Estate leasing; (b) allow credit institutions to assign a 35 % LGD for senior exposures in the form of equipment leasing; and (c) allow credit institutions to assign a 30 % LGD for senior exposures secured by residential or commercial real estate. At the end of this period, this derogation shall be reviewed."

Objective of the discretion: This option allows for a more permissive treatment: it provides for the assignment of lower levels of LGD to senior exposures in the form of Commercial Real Estate leasing and of equipment leasing, which result in lower capital requirements. The objective of this (transitional) option is not only to smooth the impact of the introduction of the new capital adequacy regime but also to accommodate the fact that the original LGDs may need to be recalibrated in 2012, taking into account the experience accumulated during that period after CRD implementation

1. **Overview of exercise:** 44% of Member States have exercised this option, 3% of which with a proviso.

2. **Reasoning and proposal:** The differing exercise of this option has an impact on business, namely on the level playing field. Despite the fact that this discretion allows for a less prudent treatment and local market characteristics are not the only factor driving the choice whether to apply this option, mutual recognition is widely suggested as a possible solution for

convergence until its expiration at the end of 2012. The Leasing industry in its public response disagreed with the argument that this is a less prudent option and recalled that LGDs for lease exposures tend to be lower than for other forms of secured finance as lessors benefit from the ownership of the leased asset, implying (amongst other factors) that they are able to repossess the leased asset without going through lengthy bankruptcy procedures or realising a pledge on the asset. Given its transitional character, and the fact that the content itself has to be reviewed in due course, this option should be **kept in the present form, including the review clause**. In 2012 (and thus before the end of its validity), it should be evaluated whether the original levels of LGD are more or less appropriate and an impact assessment should be conducted on that question. In so far as commercial real estate leasing and senior exposures secured by residential or commercial real estate are concerned, the decision on the application of this more favourable treatment may depend strongly on market and business specificities. At such time, it should, therefore, be considered whether – if the discretion is extended - the introduction of a mutual recognition clause would help to minimise level playing field distortions.

3. **Drafting proposal**: To clarify that the provision should be reviewed before the end of its validity.

By way of derogation, until 31 December 2012 the competent authorities may, subject to the levels of collateralisation indicated in Table 5: (a) allow credit institutions to assign a 30 % LGD for senior exposures in the form of Commercial Real Estate leasing; (b) allow credit institutions to assign a 35 % LGD for senior exposures in the form of equipment leasing; and (c) allow credit institutions to assign a 30 % LGD for senior exposures secured by residential or commercial real estate. Before the end of this period, this derogation shall be reviewed"

56. CRM, Annex VIII, Part 3, Para 89 (Directive 2006/48/EC)

"The competent authorities may extend the treatment provided for in Annex VI, Part 1, points 4 and 5 to exposures or parts of exposures guaranteed by the central government or central bank, where the guarantee is denominated in the domestic currency of the borrower and the exposure is funded in that currency."

Objective of the discretion: This option allows for a more permissive treatment since it offers the possibility of applying a 0% risk weight to the exposures or parts of exposures guaranteed by the central government or central bank where the guarantee is denominated in the domestic currency of the borrower and the exposure is funded in that currency, introducing consistency with the (more favourable) treatment available in the Standardised approach.

1. **Overview of exercise:** This option was exercised by 86% of Member States, 3% of which with a proviso.

2. **Reasoning and proposal:** The divergent exercise of this option has a potential impact on business, namely on the level playing field. This option is not a national discretion but a supervisory decision to be applied on a case by case basis. In principle, the implementation of this provision as a supervisory decision could be a solution. However, and despite the diversity of classifications resulting from the questionnaire, given that this option was exercised by 86% of Member States and allows for a more favourable treatment, the solution proposed is to transform it into an **option for credit institutions**. Given the conditions presented, this does not appear to have a negative prudential effect.

3. **Drafting proposal:**

Credit Institutions may extend the treatment provided for in Annex VI, Part 1, points 4 and 5 to exposures or parts of exposures guaranteed by the central government or central bank, where the guarantee is denominated in the domestic currency of the borrower and the exposure is funded in that currency.

Area: Securitisation

57. Securitisation, Article 152 (10) (b) (Directive 2006/48/EC)

"Where the discretion referred to in paragraph 8 is exercised, the following shall apply in relation to the treatment of exposures for which the Standardised Approach is used: (a). … (b). Title V, Chapter 2, Section 3, Subsection 4 concerning the treatment of securitisation may be disapplied by competent authorities.'

Objective of the discretion: To allow a transitional period before the treatment on securitisation could take effect. It expired naturally at the end of 2007.

1. **Overview of exercise:** 73% of Member States have applied this discretion, 17% have not.

2. **Reasoning and proposal:** The national discretion was put in place in order to allow a transitional period before the treatment on securitisation could take effect. The rationale was to take into account e.g. the non-availability of external ratings or other market specificities. It expired naturally at the end of 2007; therefore, it is proposed to **delete the provision**.

3. **Drafting solution:** Delete Article 152 (10) (b) of Directive 2006/48/EC.

58. Securitisation, Annex IX, Part 4, Para 30 (Directive 2006/48/EC)

"In the case of securitisations subject to an early amortization provision of retail exposures which are uncommitted and unconditionally cancellable without prior

notice and where the early amortization is triggered by a quantitative value in respect of something other than the three months average excess spread, the competent authorities may apply a treatment which approximates closely to that prescribed in points 26 to 29 for determining the conversion figure indicated."

Objective of the discretion: To simplify one computation, in certain cases, where the results only change marginally (i.e. the national discretion is capital-neutral).

1. **Overview of exercise:** 57% of Member States are exercising this discretion, 10% of which exercise it with provisos.

2. **Reasoning and proposal**: Most stakeholders perceive no impact from the divergent exercise of this national discretion (since, in most Member States no securitization framework is in place), but they also recognize its usefulness as it allows national authorities to take into account other triggers than the excess spread. This national discretion is currently only relevant for the UK market. However, to ensure consistency and a level playing field, the provision should be applicable either everywhere or nowhere. As the alternative approach is understood to be capital neutral and prudentially sound, though less clear, the proposal is to harmonize the possibility of using either method across the EU where there is a securitisation regime. This could be phrased as a supervisory decision, but the main components of the discretion are decided across the board subject to normal supervisory scrutiny in regular supervision. As a result, the proposal is to **delete the discretionary component of the provision**. This means that point 31, (that provides for other Member States' opinions to be taken into account so that further convergence on a case by case basis can be achieved) loses its rationale and should, therefore, be deleted. However, in the interest of good practice, competent authorities could still exchange views on a voluntary basis.

3. **Drafting proposal:** Deletion of Annex IX, Part 4, Para 31 (Directive 2006/48/EC) and proposal for point 30:

   'In the case of securitisations subject to an early amortisation provision of retail exposures which are uncommitted and unconditionally cancellable without prior notice and where the early amortisation is triggered by a quantitative value in respect of something other than the three months average excess spread, a treatment which approximates closely to that prescribed in points 26 to 29 for determining the conversion figure indicated shall apply.'

59. Securitisation, Article Annex IX, Part 4, Para 53 (last sentence) - (Directive 2006/48/EC)

"(…) For securitisations involving retail exposures, the competent authorities may permit the Supervisory Formula Method to be implemented using the simplifications: h=0 and v=0. (…)"

Objective of the discretion: To simplify the computation of the Supervisory Formula method in the case of securitisations involving retail exposures, where it would result in immaterial differences to capital levels (i.e. the national discretion is capital-neutral).

1. **Overview of exercise:** 90% of Member States apply this discretion, 10% of which applyng it with provisos; 7% do not apply it.

2. **Reasoning and proposal:** Most stakeholders perceive no impact from the divergent exercise of this national discretion (since, in most Member States no securitization framework is in place) and recognize that the simplification is useful for retail securitisations (i.e. where N is large, and therefore both 'h' and 'v' tend to 0 anyway). Two solutions are deemed the most viable: to delete the provision completely (once the systems are programmed to calculate the Formula, when presumably they should not need to use this national discretion) or to delete the discretionary component, effectively making it an option for the credit institutions. These solutions would allow for flexibility (especially since the use of the national discretion would result in immaterial changes to capital levels) and for the simplification to take place in a consistent manner across Member States. Considering the feedback received, CEBS's proposal is to transform the provision into **an option for credit institutions.**

3. **Drafting proposal:** Amendment of the last sentence. CEBS acknowledges that 'predominantly' does not provide for a precise definition of the number of exposures to be considered. However, since respondents to the public consultation did not provide any feedback on a possible definition, this can be identified as an area of future work.

   For securitisations involving predominantly retail exposures, the Supervisory Formula Method may be implemented by using the simplifications: h=0 and v=0.

Area: Operational Risk

60. Op Risk, Article 102.4 & Annex X, Part 4, Points 1 and 2 (Directive 2006/48/EC)

"Competent authorities may allow credit institutions to use a combination of approaches in accordance with Annex X, Part 4."

Objective of the discretion: The objective of the discretion, when applied, is to allow a pragmatic and practical approach to operational risk requirements. That is, it allows for practical implementation of the Advanced Measurement Approach ("AMA") by permitting parts of the risk portfolio to be captured by The Standardised Approach ("TSA") or Basic Indicator Approach ("BIA"). It allows credit institutions flexibility in the application of the AMA approach or in exceptional circumstances, the TSA approach. Exceptional circumstances would include for example, the occurrence of a merger or acquisition. The discretion

allows a more permissive treatment but one which is grounded in a practical approach.

1. **Overview of exercise:** 97% of Member States have applied this discretion, 10% of which with provisos.

2. **Reasoning and proposal:** The option is seen as having an impact from both a cross border and a cost basis when different rules apply. It is also seen to be a deterrent to implementing the more advanced approaches. It is unclear how transforming the option into a general rule would operate practically. It is difficult to see how the text could be amended to say that "institutions shall use a combination of approaches" without specifying an exhaustive list of circumstances. Turning the discretion into an option for credit institutions is a viable path for progress. As Annex X details the qualifications in respect of the option this also achieves convergence and is advantageous to cross-border groups, and in exceptional cases, for example to mergers. It should be noted that the set of criteria is not considered to be sufficiently strong by all Members. However, the CRD allows for a stricter application of the criteria and the competent authorities also retain oversight over the applicability of the combined use of methodologies in the context of the approval process. The proposal is thus to make it an **option for credit institutions**. It is noted that this proposal may prejudice comparability between institutions.

3. **Drafting proposal:** Convergence can be achieved by amending the Directive text as stated and it should be a relatively straightforward change given the relatively common implementation across Members.

Credit Institutions may use a combination of approaches subject to compliance with the requirements set out in Annex X, Part 4.

61. Op Risk, Article 104.3 (Directive 2006/48/EC)

"For certain business lines, the competent authorities may under certain conditions authorise a credit institution to use an alternative relevant indicator for determining its capital requirement for operational risk as set out in Annex X, Part 2, points 5 to 11."

Objective of the discretion: The objective of the discretion, when applied, is to allow for an improved basis for assessing operational risk in those institutions meeting the qualifying criteria. The discretion allows a more permissive treatment.

1. **Overview of exercise:** 63% of Member States have applied this discretion, 3% of which with provisos.

2. **Reasoning and proposal:** In CEBS's view, this provision was never intended to be a national discretion, but a supervisory decision to be applied on a case by case basis that should have been implemented as such by all Member States (the provision says "the competent authority may waive" and not the Member States). It should also be applied as such. In principle, the text of the Directive

should be kept unchanged and the Member States that have not yet implemented this provision as a supervisory decision to be used on a case by case basis should be urged to do so as soon as possible. However, there other arguments to consider when proposing a possible solution. On the one hand, some Members States questioned the risk sensitivity of the discretion and expressed their concerns over its use since in their view the conditions can never be satisfactorily fulfilled. On the other hand, Article 104.3, as well as the conditions of implementation contained in Annex X, clearly gives supervisory oversight of the ASA approach to the competent authorities (as stated in Annex X, Part 2, Point 11, and so credit institutions wishing to implement the ASA, among other requirements, must demonstrate to the competent authorities that the ASA provides an improved basis for assessing operational risk. This in general only happens in emerging countries and so the discretion is most likely to be relevant on a consolidated basis. In addition, since the possibility of using the ASA approach exists in third countries, banking groups conducting business within and outside the EU might face difficulties if this possibility is not available in the EU. Furthermore, the ASA approach is already being applied in a number of cases and it is CEBS's perception that its deletion would bring more costs than benefits. Taking into account these considerations CEBS proposes to **implement the provision as a supervisory decision to be applied on a case by case basis in the context of the approval process.**

3. **Drafting proposal**: No change necessary at the CRD level, but it should be implemented as a supervisory decision at the national level.

4. **Other remarks:** The discretion in Article 104.3 refers to conditions set out in Annex X, part 2. The Annex also includes the discretion which creates a sort of duplication. **(See also provision 63)**

62. Op Risk, Article 105.4 (Directive 2006/48/EC)

"Where an EU parent credit institution and its subsidiaries or the subsidiaries of an EU parent financial holding company use an Advanced Measurement Approach on a unified basis, the competent authorities may allow the qualifying criteria set out in Annex X, Part 3 to be met by the parent and its subsidiaries considered together."

Objective of the discretion: The objective of the discretion, when applied, is to allow a practical approach to approving AMA applications for cross-border banking groups. The discretion allows a more permissive treatment, but one which is pragmatic and cognisant of the home/host relationship.

1. **Overview of exercise:** 93% of Member States have applied this discretion, 13% of which with provisos.

2. **Reasoning and proposal:** Stakeholders are split on the importance of the impact of the differing exercise of this national discretion. Members indicated a preference for removing the discretionary part of the provision; however, removing the option may deny institutions the group-wide basis approach. Therefore, convergence should be achieved through keeping the option **for**

supervisors to decide on a case by case basis in the context of the **supervisory approval process**. In fact, it is CEBS's opinion that this provision is not intended to be a national discretion but a supervisory decision to be applied on case by case basis that should have been implemented by all Member States. It should also be applied as such. The text in the Directive should be kept unchanged and the Member States that have not yet implemented this provision as a supervisory decision to be used on a case by case basis should be urged to do so as soon as possible. A large majority of Member States have chosen to apply the discretion and competent authorities retain oversight through the AMA approval process as well as in conjunction with Article 129 home/host interaction and CEBS home/host guidelines.

3. **Drafting proposal:** No change necessary at the CRD level, but the provision should be implemented as a supervisory decision at the national level.

63. Op Risk, Annex X, Part 2, Point 3 and 5 (Directive 2006/48/EC)

Point 3: "Competent authorities may authorise a credit institution to calculate its capital requirement for operational risk using an alternative standardised approach, as set out in points 5 to 11."

Objective of the discretion: The objective of the discretion, when applied, is to allow for an improved basis for assessing operational risk in those institutions meeting the qualifying criteria. The discretion allows a more permissive treatment.

1. **Overview of exercise:** 67% of Member States have applied this discretion, 3% of which with provisos.

2. **Reasoning and proposal:** This is the same discretion as Article 104.3 and they should, therefore, be analysed together. **See provision 61** for the reasoning and proposal.

3. **Drafting proposal:** No change necessary at the CRD level, but it should be implemented as a supervisory decision at the national level.

64. Op Risk, Article 20.2 (Directive 2006/49/EC)

"By way of derogation from paragraph 1, competent authorities may allow investment firms that are not authorised to provide the investment services listed in points 3 and 6 of Section A of Annex I to Directive 2004/39/EC to provide own funds which are always more than or equal to the higher of the following: (a) the sum of the capital requirements contained in points (a) to (c) of Article 75 of Directive 2006/48/EC; and (b) the amount laid down in Article 21 of this Directive."

Objective of the discretion: The objective of the discretion, when applied, is to allow for a proportionate approach to operational risk requirements for those

investment firms with a limited licence. The discretion allows a more permissive treatment, but one which is proportionate to limited licence investment firms.

1. **Overview of exercise:** 73% of Member States have applied this discretion.

2. **Reasoning and proposal:** Members have applied the discretion on the basis of proportionality, as not granting the waiver would have a disproportionate impact on a small number of limited authorisation investment firms. Keeping the discretion **for supervisors to decide on a case by case basis** is the appropriate approach to the discretion and to convergence. In fact this provision is not intended to be a national discretion, but a supervisory decision to be applied on a case by case basis that should have been implemented by all Member States (the provision says "the competent authority may allow" and not the Member States). It should also be applied as such. The text in the Directive should be kept unchanged and the Member States that have not yet implemented this provision as a supervisory decision to be used on a case by case basis should be urged to do so as soon as possible. Convergence should be easily achieved given the number of Members which have applied the discretion and the lack of argument against it. Feedback received in the public consultation indicates that this discretion is key to ensuring that the application of the CRD is appropriately applied to lower risk firms and showed some concerns about inconsistent application of this provision, which has significant level playing field implications. CEBS Members will be encouraged to publish, within the scope of the supervisory disclosure framework, the criteria according to which they choose, or choose not, to grant this option to foster consistency.

3. **Drafting proposal:** No change necessary at the CRD level, but the provision should be implemented as a supervisory decision at the national level.

65. Op Risk, Article 20.3 (Directive 2006/49/EC)

"By way of derogation from paragraph 1, competent authorities may allow investment firms which hold initial capital as set out in Article 9, but which fall within the following categories, to provide own funds which are always more than or equal to the sum of the capital requirements calculated in accordance with the requirements contained in points (a) to (c) of Article 75 of Directive 2006/48/EC and the amount laid down in Article 21 of this Directive (…)"

Objective of the discretion: The objective of the discretion, when applied, is to allow for a proportionate approach to operational risk requirements for those investment firms with limited activity. The discretion allows a more permissive treatment, but one which is proportionate to limited activity investment firms.

1. **Overview of exercise:** 53% of Member States have applied this discretion, 3% of which with a proviso.

2. **Reasoning and proposal:** Members have applied the discretion on the basis of proportionality. This will impact on a small number of limited activity investment firms on a disproportionate basis. Keeping it as an **option for investment firms** allows for a proportionate impact on business and

convergence. One country would like to see the actual conditions of the discretion changed to become more stringent; however, this is contrary to the general consensus on proportionality. A majority of Member States have chosen to apply the discretion on the basis of proportionality. One member has some concerns on introducing a liberal approach at this point in time. However, convergence should be easily achieved given the number of Members applying the discretion and the lack of technical arguments presented thus far against applying it.

3. **Drafting proposal:**

"By way of derogation from paragraph 1, investment firms which hold initial capital as set out in Article 9, but which fall within the following categories, may provide own funds which are always more than or equal to the sum of the capital requirements calculated in accordance with the requirements contained in points (a) to (c) of Article 75 of Directive 2006/48/EC and the amount laid down in Article 21 of this Directive:(…)"

Area: Qualifying holdings outside the financial sector

66. Qualifying holdings, Article 122.1 (Directive 2006/48/EC)
"The Member States need not apply the limits laid down in Articles 120(1) and (2) to holdings in insurance companies as defined in Directives 73/239/EEC and 2002/83/EC, or in reinsurance companies as defined in Directive 98/78/EC." **Objective of the discretion:** This national discretion could be considered as a 'proxy LE' rule. It could appear as being permissive (but see below: other safeguards, solutions are in place).

1. **Overview of exercise:** 77% of Member States have applied the discretion; 23% have not.

2. **Reasoning and proposal:** A number of stakeholders identified the potential for an unlevel playing field for cross-border business due to a different composition of own funds. Prudential supervision of insurance undertakings and the material holdings deductions in the Conglomerates Directive seem to cover any need for 'flexibility' to address market and business specificities. The proposal is to **delete the discretionary part of the provision.**

3. **Drafting proposal:**

The limits laid down in Articles 120(1) and (2) shall not apply to holdings in insurance companies as defined in Directives 73/239/EEC and 2002/83/EC, or in reinsurance companies as defined in Directive 98/78/EC.

67. Qualifying holdings, Article 122.2 (Directive 2006/48/EC)

"The Member States may provide that the competent authorities are not to apply the limits laid down in Article 120 (1) and (2) if they provide that 100 % of the amounts by which a credit institution's qualifying holdings exceed those limits shall be covered by own funds and that the latter shall not be included in the calculation required under Article 75. If both the limits laid down in Article 120(1) and (2) are exceeded, the amount to be covered by own funds shall be the greater of the excess amounts."

Objective of the discretion: To continue to allow a flexible *but still prudent* method of managing qualifying holdings for those market structures where credit institutions have relatively large qualifying holdings.

1. **Overview of exercise:** 67% of Member States have exercised this discretion, 3% of which with provisos and 33% have not exercised it.

2. **Reasoning and proposal:** A number of stakeholders identified the potential for an unlevel playing field for cross-border business. This national discretion is stating that credit institutions must either keep within limits, or cover the extra position by capital. This national discretion entails a supervisory decision which takes account of the banking model in each jurisdiction. To ensure competent authorities have the necessary flexibility to deal with national and business/market specificities the tentative proposal is to **keep this national discretion in its current form**.

3. **Drafting proposal**: No change is necessary.

4. **Other remarks**: CEBS has contributed to the review of the large exposures regime with its Advice to the European Commission, which recommends that a temporary breach in the Banking Book should be allowed only in specific and extraordinary circumstances and provided the excess is deducted from own funds. However, it may be appropriate to have a differentiated approach to the breach of limits in the field of qualifying holdings outside the financial sector, because the reasoning underpinning of the two rules is quite different. In the case of the large exposures regime, the treatment of the breach of limits is driven by prudential concerns, while in the case of qualifying holdings outside the financial sector the treatment is related to the banking model in each jurisdiction.

Area: Transitional provisions

General remark: In view of the time needed for any legislative process CEBS's proposal is to **keep in their present form till the end of the transition period all transitional national discretions which expire before the end of 2011.** This proposal also takes into consideration the very short time remaining for use of the provisions in such conditions.

68. Transitional, Article 153, First sentence (Directive 2006/48/EC)

"In the calculation of risk weighted exposure amounts for exposures arising from property leasing transactions concerning offices or other commercial premises situated in their territory and meeting the criteria set out in Annex VI, Part 1, point 54, the competent authorities may, until 31 December 2012 allow a 50 % risk weight to be assigned without the application of Annex VI, Part 1, points 55 and 56."

Objective of the discretion: This national discretion temporarily allows Member States to assign a preferential 50% risk weight (50% instead of 100%) to the full amount of certain exposures related to property leasing transactions of offices and other commercial premises situated in their territories for Standardised Approach institutions without the application of special conditions. The exercise of this discretion is based on local market conditions.

1. **Overview of exercise:** 77% of Member States do not apply this option while 23 % of the Members exercise it.

2. **Reasoning and proposal:** Given the relevance of this national discretion to some Members and a specific segment of the industry and also that this national discretion is rooted in local market conditions, the proposal is to **keep the provision till the end of the transition period subject to binding mutual recognition**. This means that the decision taken by the competent authority where the collateral is located should be automatically recognised by other authorities. The importance of the national discretion for the industry should be reassessed prior to the expiration date of transition period. The feedback received during the public consultation stresses that this option corresponds to a treatment provided by previous European Directives and that by itself does not create competitive distortions as it corresponds to the situation of 'mature' markets. The industry strongly favours the introduction of a review clause as the discretion can become useful to countries where leasing is growing. CEBS has carefully considered the feedback received but is reluctant to reopen the discussion on the transitional provisions and advocates letting them expire as scheduled. Furthermore, CEBS considers that the introduction of additional review clauses is outside the scope of this advice.

3. **Drafting proposal:** Add a clause on binding mutual recognition to the CRD text.

When this discretion is exercised by the competent authorities of Member State, all institutions subject to this directive, irrespective of their location, may assign 50% risk weight to such exposures in that Member State without the application of Annex VI, Part 1, points 55 and 56

69. Transitional, Article 153, Second sentence (Directive 2006/48/EC)

"Until 31 December 2010, competent authorities may, for the purpose of defining the secured portion of a past due loan for the purposes of Annex VI, recognise collateral other than eligible collateral as set out under Articles 90 to 93."

Objective of the discretion: This is a more permissive national discretion which temporarily allows the recognition of collateral other than eligible collateral for defining the secured part of past due loans when applying SA. The exercise of this discretion is based on local market conditions.

1. **Overview of exercise:** 87% of Member States do not apply this option and only 13 % of the Members exercise it.

2. **Reasoning and proposal:** Given the short expiration date of this transitional national discretion it is proposed to **keep it in the present form till the end of the transition period**. In addition there is no or limited impact from the divergent exercise of this discretion.

3. **Drafting proposal:** No change is necessary. The provision should be deleted at the end of its validity.

70. Transitional, Article 154.1 (Directive 2006/48/EC)

"Until 31 December 2011, the competent authorities of each Member State may, for the purposes of Annex VI, Part 1, point 61, set the number of days past due up to a figure of 180 for exposures indicated in Annex VI, Part 1, points 12 to 17 and 41 to 43, to counterparties situated in their territory, if local conditions make it appropriate. The specific number may differ across product lines."

Objective of the discretion: This national discretion temporarily allows the use of a more permissive definition of past due items when applying SA: Member States may set up to 180 days past due instead of 90 days. The exercise of this discretion is based on local market conditions.

1. **Overview of exercise:** 77% of Member States do not apply this option and 23% of the Members exercise it, 10% of which with a proviso.

2. **Reasoning and proposal:** The majority of Members are in favour of removing the option immediately or after the transition period. This opinion is shared by the majority of industry respondents, although others proposed clarifying that banks with subsidiaries in the countries with longer past due periods have the choice whether to use for these subsidiaries the home or the local past due definition. It should be noted that this proposal goes against the application of the mutual recognition principle which is considered to be a possible tool for further solutions on convergence. Given the short time before its expiry, the proposal is **to keep the provision in its present form till the end of the transition period.** CEBS has carefully considered the feedback received from those respondents who are in favour of keeping this national discretion beyond its expiration date but is reluctant to reopen the discussion on the transitional provisions and advocates letting them expire as scheduled.

3. **Drafting proposal:** No change is necessary. The provision should be deleted at the end of its validity.

71. Transitional, Article 154.2 (Directive 2006/48/EC)

"For credit institutions applying for the use of the IRB Approach before 2010, subject to the approval of the competent authorities, the three years' use requirement prescribed in Article 84(3) may be reduced to a period no shorter than one year until 31 December 2009."

Objective of the discretion: The provision allows for a temporary reduction of the 3 years use test to 1 year when applying for the use of the IRB approach.

1. **Overview of exercise:** 93 % of Member States apply this option, 7% of which with a proviso and 7 % do not apply it.

2. **Reasoning and proposal:** This option is widely used by many Member States and is considered to be an important tool for the acceleration of the IRB implementation process, though some point out that for cross border groups it can mean different requirements in terms of the use test depending on the country. In CEBS's opinion this provision is not intended to be a national discretion, but a supervisory decision to be applied on a case by case basis with the aim of facilitating the IRB implementation process during the transition period for banks which have recently established their internal ratings systems. This discretion should have been implemented by all Member States. However, because of the short time remaining CEBS does not advise implementing it as a supervisory decision in all Member States. Given the very short time till the expiration of the provision and its transitional nature, it is deemed to be appropriate to **keep the supervisory decision in the present form till the end of the transitional period.** The feedback received during the consultation period points to the importance of this discretion. In general respondents suggest reviewing this provision before its expiration, to examine whether it can be maintained as a general rule since it may also be relevant to specific cases in the future (e.g. for new acquisitions of credit institutions in the SA approach). CEBS has carefully considered the feedback received but is reluctant to reopen the discussion on the transitional provisions and advocates letting them expire as scheduled, CEBS considers that the introduction of additional review clauses is outside the scope of this advice.

3. **Drafting proposal:** No change is necessary. The provision should be deleted at the end of its validity.

72. Transitional, Article 154.3 (Directive 2006/48/EC)

"For credit institutions applying for the use of own estimates of LGDs and/or conversion factors, the three year use requirement prescribed in Article 84(4) may be reduced to two years until 31 December 2008."

Objective of the discretion: Member States may temporarily allow institutions to reduce the 3 years requirement to 2 years when applying for the use of their own estimates of LGDs and/or conversion factors.

1. **Overview of exercise:** 93 % of Member States apply this option, 3% of which with a proviso while 7 % are not applying it.

2. **Reasoning and proposal:** This option is widely used by many Member States and is considered to be an important tool for the acceleration of the IRB implementation process, though some point out that for cross border groups it can mean different requirements in terms of the use test depending on the country. In CEBS's view this provision is not intended to be a national discretion but a supervisory decision to be applied on a case by case basis in order to encourage banks to move towards more risk sensitive management systems during the transition period which ends in 2008. This discretion should have been implemented by all Member States. However, because of the short time remaining, CEBS does not advise implementing it as a supervisory decision in all Member States. Given the very short expiration date of this provision the proposal is to **keep the supervisory decision in the present form till the expiration date.** CEBS has carefully considered the feedback received from some respondents suggesting reviewing this provision before its expiry date, but it is reluctant to reopen the discussion on the transitional provisions and advocates letting them expire as scheduled. Furthermore, CEBS considers that the introduction of additional review clauses is outside the scope of this advice.

3. **Drafting proposal:** No change is necessary. The provision should be deleted at the end of its validity.

73. Transitional, Article 154.4 (Directive 2006/48/EC)

"Until 31 December 2012, the competent authorities of each Member State may allow credit institutions to continue to apply to participations of the type set out in Article 57(o) acquired before 20 July 2006 the treatment set out in Article 38 of Directive 2000/12/EC as that article stood prior to 1 January 2007."

Objective of the discretion: This national discretion temporarily allows exemption of certain types of participations from the Basel II framework and the continued application of Basel I treatment.

1. **Overview of exercise:** 60 % of Member States do not apply this option, 40% apply it, 3% of which with a proviso.

2. **Reasoning and proposal:** When considering possible solutions CEBS took into account that this is a grandfathering provision temporarily allowing exemption from the Basel II framework only for those insurance undertakings which were acquired before the date specified. Given that, the proposal is **to keep this national discretion in the present form until the expiration date**. CEBS has carefully considered the feedback received from some respondents suggesting reviewing this provision before the expiration date,

but is reluctant to reopen the discussion on the transitional provisions and advocates letting them expire as scheduled. Furthermore, CEBS considers that the introduction of additional review clauses is outside the scope of this advice.

3. **Drafting proposal:** No change is necessary. The provision should be deleted at the end of its validity.

74. Transitional, Article 154.6 (Directive 2006/48/EC)

"Until 31 December 2017, the competent authorities of the Member States may exempt from the IRB treatment certain equity exposures held by credit institutions and EU subsidiaries of credit institutions in that Member State at 31 December 2007".

Objective of the discretion: National discretion temporarily allows exemption from the IRB treatment of certain equity exposures held by credit institutions and EU subsidiaries of credit institutions in particular Member States.

1. **Overview of exercise:** 53 % of Member States apply this option and 47 % do not apply it.

2. **Reasoning and proposal:** Similarly to national discretion 73, this is a grandfathering provision which is currently effective only for certain equity exposures held by the institutions at the end of 2007. Given that, the proposal is to **keep the national discretion in the present form till the expiration date**.

3. **Drafting proposal:** No change is necessary. The provision should be deleted at the end of its validity.

75. Transitional, Article 155 (Directive 2006/48/EC)

"Until 31 December 2012, for credit institutions the relevant indicator for the trading and sales business line of which represents at least 50 % of the total of the relevant indicators for all of its business lines accordance with Annex X, Part 2, points 1 to 4, Member States may apply a percentage of 15 % to the business line 'trading and sales'."

Objective of the discretion: National discretion which temporarily allows Member States to apply a preferential risk weight (15 % instead of 18 %) to the trading and sales business line when calculating TSA credit institutions capital requirement for operational risk if a certain condition is met.

1. **Overview of exercise:** 57 % of Member States do not apply this option, 43% apply it.

2. **Reasoning and proposal:** On the one hand the provision has a limited scope of application and a low relevance and impact for the majority of stakeholders,

which points towards deletion. On the other hand it would have a negative impact on institutions that use it if it is deleted prior to the end of the term set. Therefore, it is proposed **to keep this national discretion in the present form until the end of the transitional period**, consistently with national discretion 78 applicable to investment firms. CEBS has carefully considered the feedback received from some respondents suggesting that this provision should be reviewed before the expiration date, but is reluctant to reopen the discussion on the transitional provisions and advocates letting them expire as scheduled. Furthermore, CEBS considers that the introduction of additional review clauses is outside the scope of this advice.

3. **Drafting proposal:** No change is necessary. The provision should be deleted at the end of its validity.

76. Transitional, Annex VII, Part 2, Point 8 (second subparagraph) (Directive 2006/48/EC)

"Until 31 December 2010, covered bonds as defined in Annex VI, Part 1, points 68 to 70 may be assigned an LGD value of 11,25 % if (…)"

Objective of the discretion: National discretion which temporarily allows credit institutions to apply a reduced LGD value for covered bonds (11.25 % instead of 12.5 %) if certain conditions are met.

1. **Overview of exercise:** 80% of Member States apply this option, 3% of which with a proviso and 20 % of the Member States do not exercise it.

2. **Reasoning and proposal:** This is not an explicit national discretion to be exercised by Member States but is already an option for credit institutions to assign a lower LGD value for covered bonds if certain conditions are met. Given this, it would not make a sense to change the CRD wording by transforming the discretion into a general rule during the transition period. Since both the majority of Members and industry are willing to keep the provision in its present form, the proposal is to **keep the option for credit institutions in the present form**.

   However, it should be noted that the CRD already contains a provision (Annex VII, Part 2, Para. 8 last subparagraph) on the obligatory review of this derogation prior to its expiry date on 31 December 2010 and so this should be reviewed prior to that date.

3. **Drafting proposal:** No change is necessary. Following the result of the review, the article should either be extended or deleted at the end of its validity.

77. Transitional, Annex VII, Part 4, Point 66, 71, 86 and 95 (Directive 2006/48/EC)

"66. Irrespective of whether a credit institution is using external, internal, or pooled data sources, or a combination of the three, for its PD estimation, the length of the underlying historical observation period used shall be at least five years for at least one source. If the available observation period spans a longer period for any source, and this data is relevant, this longer period shall be used. This point also applies to the PD/LGD Approach to equity. Member States may allow credit institutions which are not permitted to use own estimates of LGDs or conversion factors to have, when they implement the IRB Approach, relevant data covering a period of two years. The period to be covered shall increase by one year each year until relevant data cover a period of five years. (…)"

Objective of the discretion: A more permissive requirement for the minimum length of observation periods: Member States may in the transitional period allow a reduction in the minimum length of the observation periods required for own estimations of PD, LGD and CCF, subject to an absolute minimum of 2 years.

1. **Overview of exercise:** 97% of Member States exercise this discretion, 10% of which with a proviso; only 3 % of the countries do not apply it.

2. **Reasoning and proposal:** The national discretion is widely applied across Member States in order to encourage banks to move towards more risk sensitive approaches. In fact this is not a transitional provision in the sense that it applies to credit institutions when they implement the CRD no matter the year of implementation. However, it seems to be applied, at least in a number of Member States, on a case by case basis. The proposal is to **transform the national discretion into a supervisory decision** to be applied on a case by case basis which allows the competent authority to assess the sufficiency of the data. It is noted that the provision only addresses the acceptable length of observations and not data quality issues which are covered in national discretion number 46.

3. **Drafting proposal:**

(…) Subject to the approval of competent authorities, credit institutions which are not permitted to use own estimates of LGDs or conversion factors may, when they implement the IRB Approach, use a minimum historical observation period covered by the relevant data of two years. The period to be covered shall increase by one year each year until the relevant data cover a period of five years. (…)

78. Transitional, Article 44 (Directive 2006/49/EC)

"Until 31 December 2012, for investment firms the relevant indicator for the trading and sales business line of which represents at least 50 % of the total of relevant indicators for all of their business lines calculated in accordance with Article 20 of this Directive and points 1 to 4 of Part 2 of Annex X to Directive 2006/48/EC, Member States may apply a percentage of 15 % to the business line 'trading and sales'."

Objective of the discretion: National discretion temporarily allows Member States to apply a preferential risk weight (15 % instead of 18 %) to the trading and sales business line when calculating TSA investment firms' capital requirement for operational risk if a certain condition is met.

1. **Overview of exercise:** 47% of Member States exercise this option, 33 % do not apply it.

2. **Reasoning and proposal:** Given the limited scope of application of this national discretion and its low relevance and impact for the majority of the stakeholders, it is proposed **to keep the national discretion in the present form until the expiry date**, consistently with national discretion 75 applicable to credit institutions. CEBS has carefully considered the feedback received from some respondents that this provision should be reviewed before the expiration date, but is reluctant to reopen the discussion on the transitional provisions and advocates letting them expire. The transitional period set allows institutions to anticipate and prepare for this. Furthermore, CEBS considers that the introduction of additional review clauses is outside the scope of this advice.

3. **Drafting proposal:** No change is necessary. The provision should be deleted at the end of its validity.

79. Transitional, Article 46 (Directive 2006/49/EC)

"By way of derogation from Article 20(1), until 31 December 2011 competent authorities may choose, on a case by case basis, not to apply the capital requirements arising from point (d) of Article 75 of Directive 2006/48/EC in respect of investment firms to which Article 20(2) and (3) do not apply, whose total trading book positions never exceed EUR 50 million and whose average number of relevant employees during the financial year does not exceed 100. (…)"

Objective of the discretion: More permissive alternative transitional operational risk requirement for small investment firms

1. **Overview of exercise:** 43% of Member States do not apply this option, 33% exercise it.

2. **Reasoning and proposal:** In CEBS's view, this provision is not intended to be a national discretion, but a supervisory decision to be applied on a case by case basis that should have been implemented by all Member States. However, because of the short time remaining CEBS does not advise implementing it as a supervisory decision in all Member States. The aim of the discretion is to create more favourable conditions for small investment firms during the transition period. Considering the short expiration date of the transitional provision, its limited application and impact, and that it is a grandfathering provision, the proposal is **to keep the supervisory decision in the present form until the expiry date.**

3. **Drafting proposal:** No change is necessary. The provision should be deleted at the end of its validity.

80. Transitional, Article 47 (Directive 2006/49/EC)

"Until 31 December 2009 or any earlier date specified by the competent authorities on a case by case basis, institutions that have received specific risk model recognition prior to 1 January 2007 in accordance with point 1 of Annex V may, for that existing recognition, treat points 4 and 8 of Annex V to Directive 93/6/EEC as those points stood prior to 1 January 2007."

Objective of the discretion: National discretion temporarily allows institutions to apply previously recognized specific market risk models.

1. **Overview of exercise:** 57% of Member States do not apply this option, 37% exercise it, 3% of which with a proviso.

2. **Reasoning and proposal:** This transitional provision is necessary for the banks which need to adapt their existing VaR models to the new requirements. In CEBS's opinion this provision is not intended to be a national discretion, but a supervisory decision to be applied on a case by case basis that should have been implemented by all Member States. However, because of the short time remaining CEBS do not advise implementing it as a supervisory decision in all Member States. Considering its very short expiration date, its low impact and that it is a grandfathering provision the proposal is to **keep the supervisory decision in the present form till the expiry date**.

3. **Drafting proposal:** No change is necessary. The provision should be deleted at the end of its validity.

Area: Trading book

81. Trading book, Article 18.2 and 3 (Directive 2006/49/EC)

18.2: "By way of derogation from paragraph 1, the competent authorities may allow institutions to calculate the capital requirements for their trading book business in accordance with Article 75(a) of Directive 2006/48/EC and points 6, 7, and 9 of Annex II to this Directive, where the size of the trading book business meets the following requirements: (…)

18.3: "In order to calculate the proportion that trading-book business bears to total business for the purposes of points (a) and (c) of paragraph 2, the competent authorities may refer either to the size of the combined on- and off-balance-sheet business, to the profit and loss account or to the own funds of the institutions in question, or to a combination of those measures. (…)"

Objective of the discretion: The Competent Authorities may allow institutions to apply banking book rules to their trading book exposures,

provided the trading book activities do not exceed certain limits. This treatment is not a risk-sensitive one but avoids requiring small institutions to implement complex and burdensome approaches. Generally it is not a permissive treatment.

1. **Overview of exercise:** 97% of Member States apply this option, 3% of which with a proviso.

2. **Reasoning and proposal**: Like most of the trading book options, this is not a new option introduced by Basel 2; hence supervisors and the industry have experience of its application. There is already a high degree of convergence (93% of Members exercise the discretion) and proportionality is obviously a key driver here: it would be unduly burdensome to require all institutions, notably those with very limited trading book activities, to apply the trading book rules. The proposal is to **transform article 18.2 into an option for credit institutions**, based on the existing criteria. It is noted that this proposal may cause credit institutions to calculate capital requirements in a different manner, which could undermine the comparability between institutions. The proposal is also to **keep article 18.3 in its current form.**

3. **Drafting proposal**: No change necessary in Article 18.3 and the following proposal for Article 18.2.

   18.2. By way of derogation from paragraph 1, institutions may calculate the capital requirements for their trading book business in accordance (…).

82. Trading book, Article 19.2 (Directive 2006/49/EC)

"By way of derogation from points 13 and 14 of Annex I, Member States may set a specific risk requirement for any bonds falling within points 68 to 70 of Part 1 of Annex VI to Directive 2006/48/EC which shall be equal to the specific risk requirement for a qualifying item with the same residual maturity as such bonds and reduced in accordance with the percentages given in point 71 of Part 1 to Annex VI to that Directive."

Objective of the discretion: Member States may set a reduced specific risk requirement for covered bonds booked in the trading book with reductions similar to those applied in the banking book under the standardised approach. It is a permissive treatment.

1. **Overview of exercise:** This option is exercised by 57% of Member States.

2. **Reasoning and proposal**: The views are split on this option. The differences observed might relate to a large extent to the different legal frameworks in place and the extent to which a covered bonds market exists (or is being developed). Taking into account the feedback received from the industry on the need to maintain this treatment CEBS proposes to **keep the national discretion in its current form** until a full review of the trading book rules can be conducted.

3. **Drafting proposal**: No change is necessary.

83. Trading book, Article 19.3 and Annex I, point 52 (Directive 2006/49/EC)

"If, as set out in point 52 of Annex I, a competent authority approves a third country's collective investment undertaking (CIU) as eligible, a competent authority in another Member State may make use of this approval without conducting its own assessment."

Objective of the discretion: A competent authority of one Member State may make use of the approval of another one without conducting its own assessment. Eligible third country CIU can be treated with the specific approaches defined in the CRD for CIUs (more permissive than the default risk-weight).

1. **Overview of exercise:** This option is exercised by 66% of Member States, 3% of which with a proviso.

2. **Reasoning and proposal**: In CEBS's view, this provision **is not intended to be a national discretion, but a supervisory decision** to be applied on a case by case basis that should have been implemented by all Member States (the provision refers to 'competent authority' and not to Member States). It should also be applied as such. The text of the Directive could be kept unchanged and the Member States that have not yet implemented this provision as a supervisory decision to be used on a case by case basis should be urged to do so as soon as possible. However, the possibility of **a joint assessment process** involving all supervisors that wish to participate (similar to the ECAI recognition process) should be considered. The outcome of the joint assessment process could be a public list of eligible third country CIUs that would provide a strong common basis on which national competent authorities would form their decisions on the exercise of this supervisory decision. In addition, a **non-binding mutual recognition clause** is proposed to promote convergence and to alleviate the burden of the assessment. Feedback received during the public consultation indicates that market participants welcome the joint assessment process, but also that they would like the outcome of this assessment to be binding on all supervisors. CEBS believes that this would result in a fundamental change to the existing allocation of tasks between CEBS and supervisors and more generally to the current supervisory framework. Such a change falls beyond the mandate given by the European Commission and cannot thus be recommended by CEBS. CEBS also points out that the positive experience with the joint ECAI recognition process leads to the conclusion that the process only has positive consequences for the level of harmonisation. In addition, CEBS will request its Members to disclose the list of recognised third country CIUs in the supervisory disclosure framework.

3. **Drafting proposal**:

Annex I, point 52: Third country CIUs shall be eligible if the requirements in points (a) and (e) of point 51 are met, subject to the approval process defined in article 19.3.

Article 19.3: When the eligibility of a third country CIU needs to be approved, all relevant competent authorities in the EU shall be invited to participate in a joint assessment. When, as a result of the joint assessment, a competent authority of one Member State subsequently approves a third country's collective investment undertaking (CIU) as eligible, competent authorities of another Member State may use this approval without conducting their own assessment.

84. Trading book, Article 26 (Directive 2006/49/EC)

"Where the waiver provided for in Article 22 is not exercised, the competent authorities may, for the purpose of calculating the capital requirements set out in Annexes I and V and the exposures to clients set out in Articles 28 to 32 and Annex VI on a consolidated basis, permit positions in the trading book of one institution to offset positions in the trading book of another institution according to the rules set out in Articles 28 to 32 Annexes I, V and VI. (…)"

Objective of the discretion: For the purposes of calculating consolidated capital requirements, competent authorities may authorise the offsetting of trading (trading book, commodities, etc.) positions even when they are booked in different institutions within the group, subject to certain conditions. This national discretion allows a permissive treatment, but its impact largely depends on the specific characteristics of institutions' portfolios.

1. **Overview of exercise:** This option is exercised by 67% of the Member States, 7% of which with a proviso.

2. **Reasoning and proposal**: Since this discretion corresponds to an old provision and is a more permissive treatment, deleting the provision has been considered. However, since it relates to some extent to the principles of consolidated supervision and the scope of its application, its deletion could have a significant impact and bring more costs than benefits. In any case, in CEBS's view, this provision **is not intended to be a national discretion, but a supervisory decision** to be applied on a case by case basis that should have been implemented by all Member States (the provision says "the competent authority may authorize" and not the Member States). It should also be applied as such. The text from the Directive should be kept unchanged and the Member States that have not yet implemented this provision as a supervisory decision to be used on a case by case basis should be urged to do so as soon as possible. It should be noted that some Member States expressed their concerns on the implementation of this supervisory decision in their jurisdictions since they believe the discretion should not be exercised in any circumstance.

3. **Drafting proposal**: No change necessary at the CRD level, but the provision should be implemented as a supervisory decision at the national level.

85. Trading book, Article 33.3 (Directive 2006/49/EC)

"In the absence of readily available market prices, the competent authorities may waive the requirement imposed in paragraphs 1 and 2 and shall require institutions to use alternative methods of valuation provided that those methods are sufficiently prudent and have been approved by competent authorities."

Objective of the discretion: The competent authorities, in the absence of readily available market prices, may choose not to apply daily mark to market and, instead, require institutions to apply alternative methods subject to their approval. This discretion aims at defining a prudent valuation mechanism in the absence of market prices. It is neither a permissive option nor a restrictive one.

1. **Overview of exercise:** This option is exercised by 80% of the Member States, 3% of which with a proviso.

2. **Reasoning and proposal**: The requirements for valuation and mark-to-model that were introduced in the Annex VII of Directive 2006/49/EC as a result of the trading book review (Basel 2.5) duplicate this old national discretion and are even more specific. It is thus proposed to **delete the provision** which doesn't seem to be necessary any more.

3. **Drafting proposal**: Deletion of article 33.3 of Directive 2006/49.

86. Trading book, Annex I, Point. 4, 2nd paragraph (first sentence) (Directive 2006/49/EC)

"The competent authorities may allow the capital requirement for an exchange-traded future to be equal to the margin required by the exchange if they are fully satisfied that it provides an accurate measure of the risk associated with the future and that it is at least equal to the capital requirement for a future that would result from a calculation made using the method set out in this Annex or applying the internal models method described in Annex V."

Objective of the discretion: Subject to certain conditions, the competent authorities may allow a permissive treatment of exchange-traded futures, i.e. the capital requirement would be equal to the margin required by the exchange.

1. **Overview of exercise:** 57% of Member States do not apply this option.

2. **Reasoning and proposal**: This national discretion should be analysed in conjunction with discretions 87, 89, 90, 98 and 100. The key issue is whether reliance may be placed on margining requirements as an indicator for capital requirements. Supervisors tend to question the value of margining requirements as a proxy for capital requirements, given in particular the lack of transparency regarding the calculation of margining done by some entities but also due to the diversity of calculations from one entity to the other. In addition, this provision is assigned below average importance and more importantly, a number of jurisdictions indicate that they have little experience

of the provision or there is little relevant business or both. For these reasons and based on the feedback received from the public consultation, it is proposed to **delete the provision from the CRD.**

3. **Drafting proposal**: Deletion of Annex I, Point 4, 2nd paragraph (first sentence) of Directive 2006/49/EC.

87. Trading book, Annex I, Point 4, 2nd paragraph (second sentence) (Directive 2006/49/EC)

"The competent authorities may also allow the capital requirement for an OTC derivatives contract of the type referred to in this point cleared by a clearing house recognised by them to be equal to the margin required by the clearing house if they are fully satisfied that it provides an accurate measure of the risk associated with the derivatives contract and that it is at least equal to the capital requirement for the contract in question that would result from a calculation made using the method set out in the this Annex or applying the internal models method described in Annex V."

Objective of the discretion: Subject to certain conditions, the competent authorities may allow a more permissive treatment for OTC derivatives cleared by a clearing house, i.e. the capital requirement would be equal to the margin required by the clearing house.

1. **Overview of exercise:** 37% of Member States exercise the discretion, 7% of which with a proviso and 60% do not exercise it.

2. **Reasoning and proposal**: This national discretion should be analysed in conjunction with discretions 86, 89, 90, 98 and 100. **See discretion number 86.**

3. **Drafting proposal**: Deletion of Annex I, Point 4, 2nd paragraph (second sentence) of Directive 2006/49/EC.

88. Trading book, Annex I, point 5, 2nd paragraph (Directive 2006/49/EC)

"However, the competent authorities may also prescribe that institutions calculate their deltas using a methodology specified by the competent authorities."

Objective of the national discretion: Possibility for competent authorities to prescribe the methodologies for the calculation of delta for credit institutions. This discretion, when applied, allows more restrictive treatment of the delta calculation.

1. **Overview of exercise:** 40% of Member States have applied this discretion' 3% of which with a proviso and 60% have not.

2. **Reasoning and proposal**: Exercising the discretion could place an administrative burden on supervisors and cause distortion of competition between institutions and, in addition, as far as CEBS is aware, its deletion would not have a major impact. The proposal is, therefore, to **delete the provision completely.** The competent authorities that have specified a methodology for the calculation of institutions' deltas and that consider it necessary may draw up guidelines for applying this methodology.

3. **Drafting proposal**: Deletion of Annex 1, point 5, 2nd paragraph, Directive 2006/49/EC.

89. Trading book, Annex I, point 5, 3rd paragraph, first and second sentence (Directive 2006/49/EC)

"(…) The competent authorities may allow the requirement against a written exchange-traded option to be equal to the margin required by the 30.6.2006 EN Official Journal of the European Union L 177/219 exchange if they are fully satisfied that (…) The competent authorities may also allow the capital requirement for an OTC option cleared by a clearing house recognised by them to be equal to the margin required by the clearing house if they are fully satisfied (…)".

Objective of the discretion: The objective of the discretion, when applied, is to allow institutions to use the alternative capital requirements calculation for options. It allows implementation of a proportionate approach to the calculation of credit risk capital requirements for different institutions. This discretion allows more permissive treatment in the capital requirement calculation which is proportionate to the size and sophistication of the institution

1. **Overview of exercise:** 37% of Member States have applied this discretion, 7% of which with a proviso; 63% have not.

2. **Reasoning and proposal**: This national discretion should be analysed in conjunction with discretions 86, 87, 90, 98 and 100. **See discretion number 86.**

3. **Drafting proposal**: Deletion of Annex I, point 5, 3rd paragraph, first and second sentence of Directive 2006/49/EC.

90. Trading book, Annex I, point 5, 3rd paragraph, last sentence (Directive 2006/49/EC)

"In addition they may allow the requirement on a bought exchange-traded or OTC option to be the same as that for the instrument underlying it, subject to the constraint that the resulting requirement does not exceed the market value of the option. The requirement against a written OTC option shall be set in relation to the instrument underlying it."

Objective of the discretion: The objective of the discretion, when applied, is to allow institutions to use the alternative capital requirements calculation for options. It allows implementation of a proportionate approach to the calculation of credit risk capital requirements for different institutions. This discretion allows more permissive treatment in the capital requirement calculation which is proportionate to the size and sophistication of the institution.

1. **Overview of exercise:** 50% of Member States have applied this discretion, of which 7% with a proviso.

2. **Reasoning and proposal**: This national discretion should be analysed in conjunction with discretions 86, 87, 89, 98 and 100. **See discretion number 86.**

3. **Drafting proposal**: Deletion of Annex 1, point 5.3 (2) of Directive 2006/49/EC.

91. Trading book, Annex I, point 14, next to last paragraph (Directive 2006/49/EC)

"Instruments issued by a non-qualifying issuer shall receive a specific risk capital charge of 8% or 12 % according to Table 1. Competent authorities may require institutions to apply a higher specific risk charge to such instruments and/or to disallow offsetting for the purposes of defining the extent of general market risk between such instruments and any other debt instruments."

Objective of the discretion: This provision provides the possibility for competent authorities to require a higher specific risk capital charge for a non-qualifying issuer.

1. **Overview of exercise:** 40% of Member States have applied this discretion; 60% have not.

2. **Reasoning and proposal**: Instruments issued by a non-qualifying issuer shall receive the same specific risk capital charge as an unrated corporate client under the standardised approach for credit risk. However, this may be the case when the specific risk is higher for debt instruments, which have a high yield to redemption compared to government debt securities. Institutions shall assess the underestimated specific risk of such debt instruments and apply a higher specific risk charge to such instruments and/or not apply offsetting to these debt instruments and other debt instruments for the purpose of the measurement of general market risk. CEBS has considered transforming this discretion into an option for institutions (that could be challenged by supervisors). However, the feedback received during the consultation period indicates that this proposal does not fit into the spirit of the standardised approach and, in addition, it is not clear who would be authorised to decide how banks are to calculate the higher specific risk charge. Considering this feedback the proposal **is to remove the provision (second sentence only) from the CRD**.

3. **Drafting proposal**: Deletion of Annex I, point 14, second sentence only (Directive 2006/49/EC).

Instruments issued by a non-qualifying issuer shall receive a specific risk capital charge of 8% or 12 % according to Table 1.

92. Trading book, Annex I, point 26 (Directive 2006/49/EC)

"The competent authorities may allow institutions in general or on an individual basis to use a system for calculating the capital requirement for the general risk on traded debt instruments which reflect duration, instead of the system set out in points 17 to 25, provided that the institution does so on a consistent basis."

Objective of the discretion: Use of duration instead of the standard system for the calculation of the general risk of traded debt positions. The national discretion allows the possibility for credit institutions to apply a more advanced modelling approach.

1. **Overview of exercise:** All Member States have applied this discretion.

2. **Reasoning and proposal**: This discretion is, in CEBS's view, a supervisory decision to be applied on case by case basis. This provision should have been implemented as such by all Member States. However, since the exercise of the discretion entails the application of an advanced and more risk-sensitive approach, there are clear benefits in transforming this supervisory decision **into an option for institutions.**

3. **Drafting proposal**:

Institutions may use a system for calculating the capital requirement for the general risk on traded debt instruments which reflects duration, instead of the system set out in Point 17 to 25, provided that the institution does so on a consistent basis.

93. Trading book, Annex I, point 35, 1st paragraph (Directive 2006/49/EC)

"By derogation from point 34, the competent authorities may allow the capital requirement against specific risk to be 2 % rather than 4 % for those portfolios of equities that an institution holds which meet the following conditions: (…)"

Objective of the discretion: Possibility for competent authorities to reduce the specific risk capital charge for certain equity portfolios. This discretion, when applied, allows a more permissive treatment.

1. **Overview of exercise:** 80% of Member States have applied this discretion; 20% have not.

2. **Reasoning and proposal**: This discretion allows for the possibility of differentiating the specific risk requirement in equity portfolios that comply with the conditions laid out in the Directive. The difference in weighting should be seen as an appropriate differentiation between a highly rated, diversified and liquid portfolio versus a portfolio that does not possess these characteristics. This treatment is consistent with the CRD approach to risk sensitivity and should be seen as a rule that encourages institutions to hold better quality and diversified portfolios. This discretion, in CEBS's view, is **not intended to be a national discretion, but a supervisory decision to be applied on a case by case basis**. This provision should have been implemented as such by all Member States. It should also be applied as such. The text of the Directive could be kept unchanged and the Member States that have not yet implemented this provision as a supervisory decision to be used on a case by case basis should be urged to do so as soon as possible. However, since a large majority of Member States have chosen to apply the discretion and the criteria are defined, CEBS has considered whether to transform it into an option for credit institutions, but since the criteria are subjective and no objective criteria were produced in the feedback received during the public consultation, CEBS has rejected this possible solution for the time being.

3. **Drafting proposal:** No change is necessary at the CRD level, but the provision should be implemented as a supervisory decision at the national level.

94. Trading book, Annex I, point 35, 2nd paragraph (Directive 2006/49/EC)

"For the purpose of point (c), the competent authorities may authorise individual positions of up to 10% provided that the total of such positions does not exceed 50% of the portfolio."

Objective of the discretion: Possibility for Member States' supervisors to set alternative criteria for an individual position included in an institution's equity portfolio with a reduced risk weight. This discretion, when applied, allows a more permissive treatment.

1. **Overview of exercise:** 70% of Member States have applied this discretion.

2. **Reasoning and proposal**: This discretion can be exercised only if the provision in the discretion number 93 has been exercised and the analysis is dependent on the decision reached on discretion 93. In CEBS's view, this provision is not intended to be a national discretion, but a supervisory decision to be applied on a case by case basis because applying it allows changes in the criteria for an equity portfolio's structure. This provision should have been implemented as such by all Member States. However, since the discretion allows supervisors to take into account the proportionality of business and diversification of the portfolio, and that its divergent exercise can have an impact on institutions with significant equities portfolios and on cross-border groups in terms of administrative and capital burden, the cost/benefit analysis

indicates that the proposal should be to **delete the discretionary part of the provision**.

3. **Drafting proposal**: Deletion of Annex I, point 35, last sentence (discretion) of Directive 2006/49/EC and rewording Point 35(c) as follows:

no individual position exceeds 10 % of the portfolio's gross value. The sum of positions which individually represent between 5 % and 10 % of the portfolio's gross value does not exceed 50 % of the portfolio's gross value.

95. Trading book, Annex III, point 2.1, last sentence (Directive 2006/49/EC)

"The competent authorities shall have the discretion to allow institutions to use the net present value when calculating the net open position in each currency and in gold."

Objective of the discretion: The competent authorities have the discretion to allow institutions to use net present value when determining their open positions in currencies or gold. The provision allows an alternative method for the valuation of positions.

1. **Overview of exercise:** 80% of Member States has implemented this provision.

2. **Reasoning and proposal:** In CEBS's opinion this provision is not intended to be a national discretion, but a supervisory decision to be applied on a case by case basis that should have been implemented by all Member States. However, having considered the feedback received during the consultation period, CEBS's proposal is to transform this supervisory decision into an **option for credit institutions for currencies and maintain the current treatment of gold as a supervisory decision.** Member States that have not yet implemented this provision as a supervisory decision to be used on a case by case basis (for the part referring to the treatment of gold) should be urged to do so as soon as possible. CEBS's proposal would allow all credits institutions to choose between the two approaches for currencies in line with current practice. The treatment of gold has not been transformed into an option for credit institutions as CEBS prefers to continue to allow implementation to be a supervisory decision since there would be more subjectivity involved if net present value was used as a valuation method.

   One Member State has noted that they would prefer to keep this discretion in its current form, because in their opinion fair value models are not, especially at the moment, at a satisfactory degree of development. Another has expressed concern over using net present value as a valuation method for gold. CEBS's proposal is made subject to a recommendation that further technical work can be done to provide guidance on the working of the new article, when implemented. This will be based amongst other things on discussions with relevant firms by CEBS and/or those Members States with residual concerns.

3. **Drafting proposal**:

Institutions may use net present value when calculating the net open positions in each currency provided that the institution makes this choice consistently.

The competent authorities shall have the discretion to allow institutions to use the net present value when calculating the net open position in gold.

96. Trading book, Annex III, point 3.1 (Directive 2006/49/EC)

"The competent authorities may allow institutions to provide lower capital requirements against positions in closely correlated currencies than those which would result from applying points 1 and 2 to them. The competent authorities may deem a pair of currencies to be closely correlated only if (…) "

Objective of the discretion: The provision provides an alternative calculation method that is more permissive.

1. **Overview of exercise:** 57% of Member States have implemented this discretion; 43% have not.

2. **Reasoning and proposal**: In CEBS's view, this provision is not intended to be a national discretion, but a supervisory decision to be applied on a case by case basis that should have been implemented as such by all Member States. On the one hand the provision applies in particular to Member Sates where the currency (other than the Euro) is closely related with the Euro, and vice versa. On the other hand the provision seems to have lost its relevance in the Members States where the Euro has been introduced. Feedback received during the consultation period states that it is the industry's collective experience that lower capital requirements are justified in the case of closely correlated currencies, i.e. to allow these lower capital levels for supervisory purposes is the more "risk-sensitive" approach. Based on this input, CEBS's proposal is to transform the provision into **an option for institutions.**

3. **Drafting proposal**:

Institutions may provide lower capital requirements against positions in closely correlated currencies than those which would result from applying points 1 and 2 to them. A pair of currencies is deemed to be closely correlated only if (…) "

97. Trading book, Annex IV, point 7 (Directive 2006/49/EC)

"The competent authorities may regard the following positions as positions in the same commodity:

(a) positions in different sub-categories in cases where the sub-categories are deliverable against each other; and

(b) positions in similar commodities if they are close substitutes and if a minimum correlation of 0,9 between price movements can be clearly established over a minimum period of one year."

Objective of the discretion: This provision extends position netting in some cases, different but closely linked commodities to be treated the same, for the purposes of calculating the position in a commodity. It is permissive.

1. **Overview of exercise:** 80% of Member States have implemented this provision, of which 3% with a proviso.

2. **Reasoning and proposal**: In CEBS's view, this provision is not intended to be a national discretion, but a supervisory decision to be applied on a case by case basis. A choice will need to be made between keeping this provision and deleting the discretionary part of it (keeping it as a choice for banks is regarded as a subset of the latter, as banks will in any event be free not to regard closely linked commodities as the same). This substantially leaves only the question whether supervisors want to be involved before this provision is applied, or not. As this is deemed not to be the case, the proposal is to **delete the discretionary part of the provision**; this will achieve consistent treatment and avoid competitive distortions.

3. **Drafting proposal**:

For the purposes of calculating a position in a commodity, the following positions shall be regarded as positions in the same commodity:"

[criteria (a) and (b) remain the same as currently in the directive].

98. Trading book, Annex IV, point 8 (Directive 2006/49/EC)

"The competent authorities may allow the capital requirement for an exchange-traded future to be equal to the margin required by the exchange if they are fully satisfied that (…). The competent authorities may also allow the capital requirement for an OTC commodity derivatives contract of the type referred to in this point cleared by a clearing house recognised by them to be equal to the margin required by the clearing house if (…) "

Objective of the discretion: The objective of the discretion, when applied, is to allow institutions to use an alternative capital requirements calculation. This discretion allows more permissive treatment in the capital requirement calculation.

1. **Overview of exercise:** 36% of Member States have implemented this provision of which 3% with a proviso; 64% have not.

2. **Reasoning and proposal**: This national discretion should be analysed in conjunction with discretions 86, 87, 89, 90 and 100. **See discretion number 86.**

3. **Drafting proposal:** Deletion of Annex 4, point 8, Directive 2006/49/EC.

99. Trading book, Annex IV, point 10, 2nd paragraph (Directive 2006/49/EC)

"However, the competent authorities may also prescribe that institutions calculate their deltas using a methodology specified by the competent authorities."

Objective of the discretion: Possibility for competent authorities to prescribe the methodologies for the calculation of delta for credit institutions. This discretion, when applied, allows more restrictive treatment of the delta calculation

1. **Overview of exercise:** 37% of Member States have implemented the provision, of which 7% with a proviso and 63% have not implemented it.

2. **Reasoning and proposal**: In CEBS's view, this provision is not intended to be a national discretion but a supervisory decision to be applied on a case by case basis. However, since exercising the discretion could cause administrative burden for supervisors and distortion of competition between institutions, the proposal is to **delete the provision completely**. The institution has the responsibility for calculating the delta and supervisors should not take over their responsibility. The competent authorities that have specified a methodology for the calculation of institutions' deltas and consider it necessary can draw up guidelines for applying this methodology.

3. **Drafting proposal**: Deletion of Annex 4, point 10, Directive 2006/49/EC.

100. Trading book, Annex IV, point 10, three last paragraphs (Directive 2006/49/EC)

"The competent authorities may allow the requirement for a written exchange-traded commodity option to be equal to the margin required by the exchange if they are fully satisfied that (…). The competent authorities may also allow the capital requirement for an OTC commodity option cleared by a clearing house recognised by them to be equal to the margin required by the clearing house if (…). In addition they may allow the requirement on a bought exchange-traded or OTC commodity option to be the same as that for the commodity underlying it, subject to the constraint that the resulting requirement does not exceed the market value of the option. The requirement for a written OTC option shall be set in relation to the commodity underlying it."

Objective of the discretion: The objective of the discretion, when applied, is to allow institutions to use an alternative capital requirements calculation. This discretion allows more permissive treatment in the capital requirement calculation.

1. **Overview of exercise:** 43% of Member States have implemented this provision, of which 7% with a proviso and 57% have not.

2. **Reasoning and proposal**: This national discretion should be analysed in conjunction with discretions 86, 87, 89, 90 and 98. **See discretion number 86.**

3. **Drafting proposal**: Deletion of Annex 4, point 10, three last subparagraphs, Directive 2006/49/EC.

101. Trading book, Annex IV, point 14 (Directive 2006/49/EC)

"Competent authorities may allow positions which are, or are regarded pursuant to point 7 as, positions in the same commodity to be offset and assigned to the appropriate maturity bands on a net basis for the following:

(a) positions in contracts maturing on the same date; and

(b) positions in contracts maturing within 10 days of each other if the contracts are traded on markets which have daily delivery dates."

Objective of the discretion: This provision entails a more permissive treatment by extending the possibility for offsetting positions.

1. **Overview of exercise**: 90 % of Member States have implemented this provision.

2. **Reasoning and proposal**: As there is a consensus among supervisors and the industry to retain the substance of the provision and the exercise of the discretion is advantageous to banks as it permits offsetting, i.e. a reduction of positions, CEBS proposes to transform the discretion into **an option for credit institutions**.

3. **Drafting proposal**:

Positions, which are, or are regarded pursuant to point 7 as positions in the same commodity may be offset and assigned to the appropriate maturity band on a net basis for the following: (…).

ADDITIONAL PROVISIONS

Provisions included in this section are either mutual recognition clauses (and corresponding national discretions) or provisions brought to CEBS's attention by industry's respondents in their answers to CEBS's public questionnaire.

Area: CRM

102. CRM, Annex VIII, Part 1, point 16, 1st sentence (Directive 2006/48/EC)

"The competent authorities may waive the requirement for their credit institutions to comply with condition (b) in point 13 for exposures secured by residential real estate property situated within the territory of that Member State if the competent authority have evidence that (...)."

1. **Overview of exercise:** This discretion and its mutual recognition clause (103) were analysed by CEBS in its mutual recognition work. Based on the data reported, 40% of Member States have applied this discretion, 3% has not yet decided and for 57% Member States this discretion is not applicable.

2. **Reasoning and proposal:** As with the other discretions with respect to the real estate market it was agreed that local supervisors are best suited to asses whether these criteria are met for their markets. CEBS is of the opinion that this discretion should be **kept as it is but with the addition of a binding mutual recognition clause.**

3. **Drafting proposal:** No change necessary (for binding mutual recognition clause, see provision 103).

4. **Other remarks:** Competent authorities should fully disclose the manner of their exercise of this national discretion in the supervisory disclosure framework, if they do not do so already.

103. CRM, Annex VIII, Part 1, point 16, last sentence, (Directive 2006/48/EC)

"This shall not prevent the competent authorities of a Member State, which do not use this waiver from recognising as eligible residential real estate property recognised as eligible in another Member State by virtue of the waiver. Member States shall disclose publicly the use they make of this waiver."

1. **Overview of exercise:** Based on data reported for the mutual recognition exercise, 20 Members will recognise, as a principle, host rules for this discretion at a consolidated level in all cases; 4 Members will do it but only when the relative importance of the specific subsidiary within the total group is low and consolidated solvency is not eroded; 5 Members will only recognize host rules in other specific circumstances; and 1 Member will not.

2. **Reasoning and proposal: See provision 102.**

3. **Drafting proposal:** Transform it into a binding mutual recognition clause.

The competent authorities of a Member State shall recognise as eligible residential real estate property recognised as eligible in another Member State by virtue of the waiver. Member States shall disclose publicly the use they make of the waiver.

104. CRM, Annex VIII, Part 1, point 17 (Directive 2006/48/EC)

"The competent authorities of the Member States may waive the requirement for their credit institutions to comply with the condition in point 13(b) for commercial real estate property situated within the territory of that Member State, if the competent authorities have evidence that the relevant market is well-developed and long-established and that loss-rates stemming from lending secured by commercial real estate property satisfy the following conditions (…)"

1. **Overview of exercise**: This national discretion and its mutual recognition clause (105) are similar to numbers 102 and 103. These were also analysed in the context of CEBS's work on mutual recognition and 20% of Member States have applied this discretion, 3% have not yet finally decided and for 77% of the Member States this discretion is not applicable.

2. **Reasoning and proposal:** As with the other discretions with respect to the real estate market it was agreed that local supervisors are best suited to assess whether these criteria are met for their markets. This allows local assessment of contract law, real estate law, bankruptcy law and market circumstances, through which the level playing field for all institutions active in that market should be ensured. CEBS is, therefore, of the opinion that this discretion should be **kept as it is but with the addition of a binding mutual recognition clause.**

3. **Drafting proposal:** No change necessary (for the binding mutual recognition clause see provision 105).

4. **Other remarks:** The supervisory disclosure framework would have to be amended to include information on the exercise of this discretion. Competent authorities should fully disclose the manner of their exercise of this national discretion in the supervisory disclosure framework.

105. CRM, Annex VIII, Part 1, point 19 (Directive 2006/48/EC)

"The competent authorities of a Member State may recognise as eligible collateral commercial real estate property recognised as eligible collateral in another Member State by virtue of the waiver provided for in point 17".

1. **Overview of exercise:** Based on data reported for the mutual recognition exercise, 19 Members will recognise in all cases, as a principle, host rules for this discretion at a consolidated level; 4 Members will recognise it only when

the relative importance of the specific subsidiary within the total group is low and consolidated solvency is not eroded; 5 only in other specific circumstances; and 2 Members will not recognise it.

2. **Reasoning and proposal: See provision 104.**

3. **Drafting proposal:** Transform it into a binding mutual recognition clause.

The competent authorities of a Member State shall recognise as eligible collateral commercial real estate property recognised as eligible collateral in another Member State by virtue of the waiver provided for in point 17

106. CRM, Annex VIII, Part 1, point 25 (Directive 2006/48/EC)

"Instruments issued by third party institutions which will be repurchased by that institution on request may be recognised as eligible credit protection."

1. **Reasoning and proposal**: This provision is neither a national discretion nor a supervisory decision. It is part of the list of "other funded credit protection" considered eligible for the purpose of credit risk mitigation. In the current wording of the Directive, the use of these kinds of instruments is **an option for institutions.**

2. **Drafting proposal**: No changes necessary because the provision is an option for credit institutions. To clarify this, the Commission could consider replacing the word 'recognised' by 'used'.

107. CRM, Annex VIII, Part 1, point 8 (Directive 2006/48/EC)

"Debt securities issued by institutions which securities do not have a credit assessment by an eligible ECAI may be recognised as eligible collateral if they fulfil the following criteria: (…)".

1. **Reasoning and proposal:** This provision is neither a national discretion nor a supervisory decision. It is a provision that specifies part of the list of eligible collateral under all approaches and methods. In the current wording of the Directive, the use of these kinds of instruments is **an option for credit institutions, subject to the fulfilment of a set of conditions**. Competent authorities should be satisfied that those conditions are met as part of their on-going supervision activities.

2. **Drafting proposal:** No changes necessary because the provision is an option for credit institutions. To clarify this, the Commission could consider replacing the word 'recognised' by 'used'.

108. CRM, Annex VIII, Part 2, point 16 (Directive 2006/48/EC)

"Where an exposure is protected by a guarantee which is counter-guaranteed by a central government or central bank, a regional government or local authority, a public sector entity, claims on which are treated as claims on the central government in whose jurisdiction they are established under Articles 78 to 83, a multi-lateral development bank to which a 0 % risk weight is assigned under or by virtue of Articles 78 to 83, or a public sector entity, claims on which are treated as claims on credit institutions under Articles 78 to 83, the exposure may be treated as protected by a guarantee provided by the entity in question, provided the following conditions are satisfied: (…)"

1. **Reasoning and proposal**: This provision is not a national discretion or a supervisory decision. In the current wording of the Directive, this is **an option for institutions, subject to the fulfilment of a set of defined conditions**. Competent authorities should be satisfied that those conditions are met as part of their on-going supervision activities.

2. **Drafting proposal**: No changes necessary because the provision is an option for credit institutions.

109. CRM, Annex VIII, Part 3, point 59 (Directive 2006/48/EC)

"Where a competent authority permits the treatment set out in point 58 to be applied in the case of repurchase transactions or securities lending or borrowing transactions in securities issued by its domestic government, then other competent authorities may choose to allow credit institutions incorporated in their jurisdiction to adopt the same approach to the same transactions."

1. **Reasoning and proposal:** This provision is meant to be a mutual recognition clause. Since the provision in Annex VIII, Part 3, point 58 to which it refers is not a national discretion any more – in a draft version of the Directive it was in fact a national discretion - but an option for credit institutions (subject to compliance with the defined conditions), this **mutual recognition clause should be deleted from the CRD**.

2. **Drafting proposal**: Deletion of Annex VIII, Part 3, point 59.

110. CRM, Annex VIII, Part 3, point 73 (Directive 2006/48/EC)

"Subject to the requirements of this point and point 74 and as an alternative to the treatment in points 68 to 72, the competent authorities of a Member State may authorise credit institutions to assign a 50 % risk weight to the Part of the exposure fully collateralised by residential real estate property or commercial real estate property situated within the territory of the Member State if they have evidence that the relevant markets are well-developed and long-established with loss-rates from lending collateralised by residential real estate property or commercial real estate property respectively that do not exceed the following limits (…)"

1. **Overview of exercise:** Based on data reported for CEBS's mutual recognition exercise, 40% of Member States have exercised this option, 57% of Member States have not recognised it and 7% had not yet decided.

2. **Reasoning and proposal**: This discretion allows for a less demanding treatment in the calculation of the mitigating effects of real estate collateral for those institutions applying the IRB approach. The treatment entailed in this discretion may only be authorised by competent authorities if they have evidence that local markets are well developed and long established and that loss rates from RRE and CRE loans do not exceed the specified limits. Therefore, the exercise of this option is rooted in local market conditions/specificities. Consistent with previous proposals (please see provisions 102 to 105), the proposal is to **keep this provision in the present form but with a binding mutual recognition clause** to avoid distortions in the level playing field (see provision 111).

3. **Drafting proposal**: No changes necessary (for binding mutual recognition clause, see provision 111).

4. **Other remarks:** The supervisory disclosure framework would have to be amended to include information on the exercise of this discretion. Competent authorities should fully disclose the manner of their exercise of this national discretion in the supervisory disclosure framework.

111. CRM, Annex VIII, Part 3, point 75 (Directive 2006/48/EC)

"The competent authorities, which do not authorise the treatment in point 73, may authorise credit institutions to assign the risk weights permitted under this treatment in respect of exposures collateralised by residential real estate property of commercial real estate property respectively located in the territory of those Member States the competent authorities of which authorise this treatment subject to the same conditions as apply in that Member State."

1. **Overview of exercise**: Based on the data reported for CEBS's mutual recognition exercise, 97% of Members (including 37% that would do it subject to conditions) indicated that they would, as home supervisors, recognise, as a principle, host rules for this discretion at a consolidated level.

2. **Reasoning and proposal:** This is a mutual recognition clause relating to the alternative treatment provided for in Annex VIII, Part 3, point 73. The objective is to minimise costs arising from competitive distortions that result from differences in legal frameworks between Member States. As the local supervisor is typically in the best position to assess whether the requirements referring to local market conditions are met, the consolidating/home supervisor should apply recognition of the host rules for this discretion at a consolidated level. As referred to in 110, **this mutual recognition clause should be transformed into a binding provision**. As a result it should not be included in the supervisory disclosure framework. Nevertheless, those Members that apply this national discretion should disclose information

regarding their practical understanding of compliance with the conditions set in the Directive.

3. **Drafting proposal**: Transform it into a binding mutual recognition clause.

"The competent authorities, which do not authorise the treatment in point 73, shall authorise credit institutions to assign the risk weights permitted under this treatment in respect of exposures collateralised by residential real estate property or commercial real estate property respectively located in the territory of those Member States the competent authorities of which authorise this treatment subject to the same conditions as apply in that Member State."

Area: IRB

112. IRB, Annex VII, Part 4, point 44, last sentence (Directive 2006/48/EC)

"In all cases, the exposure past due shall be above the threshold defined by the competent authorities and which reflects a reasonable level of risk"

1. **Reasoning and proposal**: The impact and importance of this national discretion is not totally clear. However, the feedback received during the public consultation advocates that the provision for competent authorities to define thresholds should be deleted from the CRD, and it should state explicitly that it is up to firms to define the threshold. It is indeed the core business of banks to define risk parameters and the threshold above which an exposure should be considered past due. This threshold will also vary between institutions. CEBS highlights that under Pillar 1 a harmonized treatment is preferable and individual risk assessments play a role in Pillar 2. There is, therefore, an argument for achieving more consistency of thresholds, possibly via supervisory transparency. For clarity, CEBS considers that there is a need for thresholds and that removing the entire provision would not allow institutions to apply any threshold and that this would be an undesirable consequence. The practice is at the moment not clear, and appears to be impacted by different standards of living (and thus what absolute number reflects a reasonable level of risk in the various Member States). In the absence of a clear agreement on how to move forward, CEBS considers that the best option is to retain this national discretion **in its current form.** To alleviate any negative effects CEBS will request its Members to disclose in the supervisory disclosure framework the thresholds defined by them, which may lead to further harmonisation in practice.

2. **Drafting proposal:** No change necessary.

3. **Other remarks:** The supervisory disclosure framework would have to be amended to include information on the exercise of this discretion. Competent authorities should fully disclose the manner of their exercise of this national discretion in the supervisory disclosure framework.

113. IRB, Annex VII, Part 4, point 48, 1st and 2nd sentence (Directive 2006/48/EC)

"For retail and PSE exposures, the competent authorities of each Member State shall set the exact number of days past due that all credit institutions in its jurisdiction shall abide by under the definition of defaults set out in §44, for exposures to such counterparts situated within this Member State. The specific number shall fall within 90-180 days and may differ across product lines. (...)"

1. **Reasoning and proposal:** This is an important discretion, since it deals with one of the most debated issues in the IRB framework: the definition of default. There is still an inconsistency between the Standardised and the IRB approaches as regards the number of days past due for retail and PSEs exposures: in the former, the option to set a number up to 180 days is possible only up to 2011, as for corporate exposures. The behaviour of counterparties is quite different across Members as well as between retail and PSEs. CEBS believes that more time is necessary to assess the need for this national discretion; therefore, a preliminary proposal is to **keep the discretion as it is, with the introduction of a review clause**.

2. **Drafting proposal:** No change necessary except the addition of a review clause.

(…) Before 30 December 2014 this provision shall be reviewed.

114. IRB, Annex VII, Part 4, point 48, last sentence (Directive 2006/48/EC)

"For exposures to such counterparts situated in the territories of other Member States, the competent authorities shall set a number of days past due which is not higher than the number set by the competent authority of the respective Member State."

1. **Reasoning and proposal:** This is the mutual recognition clause for the discretion in 113: as such, the consolidating/home supervisor can recognise the host rules for this discretion at a consolidated level. See provision 113 for the reasoning behind the provision. Further experience should be gained. As this reflects a basic difference in supervisory opinions, binding mutual recognition cannot be proposed at this stage. Therefore, CEBS's proposal is to **keep the mutual recognition clause in the present form**.

2. **Drafting proposal:** No change necessary.

115. IRB, Article 85.1 and 85.2 (Directive 2006/48/EC)

"(…) Subject to the approval of the competent authorities, implementation may be carried out sequentially across the different exposure classes (…)

(…) Implementation as referred to in paragraph 1 shall be carried out within a reasonable period of time to be agreed by the competent authorities(…)"

1. **Reasoning and proposal:** This provision is not a national discretion but a supervisory decision that is **part of the overall IRB supervisory approval process**. The proposal is to **keep it as a supervisory decision.**

2. **Drafting proposal:** No change necessary since the provision is part of the IRB supervisory approval process.

116. IRB, Article 89.1 last sentence (Directive 2006/48/EC)

"This paragraph shall not prevent the competent authorities of other Member States to allow the application of the rules of Subsection 1 (standardised approach) for equity exposures which have been allowed for this treatment in other Member States"

1. **Overview of exercise**: This mutual recognition clause and the corresponding national discretions (see 118 and 119) were analysed in the context of CEBS's mutual recognition work. According to this analysis 70% of Member States have applied this discretion, 3% has not yet decided and for 20% of Member State this discretion is not applicable.

2. **Reasoning and proposal:** Specific types of equity exposures can be permanently exempted from the IRB. The local supervisor is typically in the best position to assess whether the specific equity exposures in its market meet the requirements, and that application of the standardised approach is justifiable. As such, the consolidating/home supervisor will apply recognition of the host rules for this discretion at a consolidated level. Depending on the specifics of the situation this recognition can be either unconditional or conditional. Conditions that are applied in assessing recognition are: i) use of the standardised approach for these exposures is in line with the overall specifics of the IRB application of the institution in question; ii) relatively low importance of the specific exposures in total group solvency; iii) consolidation of sub/branch by aggregation instead of line by line; and iv) proper risk profile and management of the group as a whole. If the importance of the specific exposures in total group solvency is not low, recognition could still be applied after further analysis has been done. In this analysis arguments of possible competitive disadvantage are relevant elements to assess. The proposal is to **keep this mutual recognition clause in its present form**.
3. **Drafting proposal:** See provision 117. It would also be useful to clarify in the text that the mutual recognition only applies to points (f) and (g).

117. IRB, Article 89.1 (Directive 2006/48/EC)

"Subject to the approval of the competent authorities, credit institutions permitted to use the IRB approach (…) for one or more exposure classes may apply Subsection 1 (standardised approach) for the following (…)"

1. **Reasoning and proposal:** This provision is not a national discretion. It sets out the criteria in a useful manner to both industry and supervisors for the building and assessment of models for the IRB. Also taking into account the feedback received in the public consultation, CEBS's proposal is to **keep this provision in its current form,** though it would be helpful to distinguish between the following two cases:

   - those provisions which imply supervisory decisions to be taken on a case by case basis. These are part of the IRB approval process (paragraphs a), b) c) of Article 89.1).

   -those provisions which imply a general decision by the supervisor and which, therefore, will be applied to all institutions in its jurisdiction (paragraphs d), e) f) g), h) i) of Article 89.1).

2. **Drafting proposal***:* None.

118. IRB, Article 89.1 (f) (Directive 2006/48/EC)

Credit institutions permitted to use the IRB approach may apply the Standardised approach for "equity exposures to entities whose credit obligations qualify for a 0% risk weight under subsection 1" (Standardised approach)

See provision 117.

119. IRB, Article 89.1 (g) (Directive 2006/48/EC)

Credit institutions permitted to use the IRB approach may apply the Standardised approach for "equity exposures incurred under legislative programmes (…)".

See provision 117.

Area: Large Exposures

(This area is not within the scope of the CEBS's National Discretions mandate because it is included in the current review of the large exposures regime)

120. Large Exposures, Article 110.3 (Directive 2006/48/EC)

"Member States may require credit institutions to analyse their exposures to collateral issuers for possible concentrations and where appropriate take action or report any significant findings to their competent authority".

See above.

121. Large Exposures, Article 114.1 (Directive 2006/48/EC)

"Subject to paragraph 3, for the purposes of calculating the value of exposures for the purposes of Article 111(1) to (3) Member States may, in respect of credit institutions using the Financial Collateral Comprehensive Method under Articles 90 to 93, in the alternative to availing of the full or partial exemptions permitted under points (f), (g), (h), and (o) of Article 113(3), permit such credit institutions to use a value lower than the value of the exposure, but no lower than the total of the fully-adjusted exposure values of their exposures to the client or group of connected clients. (…)".

See above.

122. Large Exposures, Article 114.2 (Directive 2006/48/EC)

"Subject to paragraph 3, a credit institution permitted to use own estimates of LGDs and conversion factors for an exposure class under Articles 84 to 89 may be permitted, where it is able to the satisfaction of the competent authorities to estimate the effects of financial collateral on their exposures separately from other LGD□relevant aspects, to recognise such effects in calculating the value of exposures for the purposes of Article 111(1) to (3). (…) Credit institutions permitted to use own estimates of LGDs and conversion factors for an exposure class under Articles 84 to 89 which do not calculate the value of their exposures using the method referred to in the first subparagraph may be permitted to use the approach set out in paragraph 1 or the exemption set out in Article 113(3)(o) for calculating the value of exposures. A credit institution shall use only one of these two methods".

See above.

123. Large Exposures, Article 114.4 (Directive 2006/48/EC)

"Where the effects of collateral are recognised under the terms of paragraphs 1 or 2, Member States may treat any covered Part of the exposure as having been incurred to the collateral issuer rather than to the client."

See above.

Area: Operational risk

124. Op Risk, Annex X, Part 3, Point 11 (Directive 2006/48/EC)

"Correlations in operational risk losses across individual operational risk estimates may be recognised only if credit institutions can demonstrate to the

satisfaction of the competent authorities that their systems for measuring correlations are sound, implemented with integrity, and take into account the uncertainty surrounding any such correlation estimates, particularly in periods of stress. The credit institution must validate its correlation assumptions using appropriate quantitative and qualitative techniques."

1. **Reasoning and proposal:** This is a discretion proposed for review by the industry. The objective of the discretion, when granted, is to allow for the recognition of correlations in Operational Risk losses in the AMA approach where correlations arise from risk estimates. Member States may grant the waiver as part of the AMA approval process. This will affect credit institutions seeking AMA approval. Industry responses are consonant with changing the wording of the Directive to replace competent authority optional oversight with a general rule. The removal of this option is straightforward as the competent authorities retain supervisory oversight, in that they will not be able to grant the waiver unless the credit institution satisfies the competent authority on the criteria described. However, it must be noted that on the basis of Cost/Benefit Analysis there is probably little benefit to either the competent authorities or the credit institutions in changing the wording of this particular point in the Annex. It is proposed to **delete the discretionary part of the provision**, as it is part of the model approval process.

2. **Drafting proposal:**

Correlations in operational risk losses across individual operational risk estimates shall be recognised only if credit institutions can demonstrate to the satisfaction of the competent authorities that their systems for measuring correlations are sound, implemented with integrity and take into account the uncertainty surrounding any such correlation estimates, particularly in periods of stress. The credit institution must validate its correlation assumptions using appropriate quantitative and qualitative techniques.

Area: Securitisation

125. Securitisation, Annex IX, Part 4, point 43 (Directive 2006/48/EC)

"Subject to the approval of the competent authorities, when the following conditions are satisfied a credit institution may attribute to an unrated position in an ABCP programme a derived rating as laid down in point 44: (…)"

1. **Reasoning and proposal:** This provision is not a national discretion; it is a supervisory decision exercised on a case by case basis because the provision sets out conditions which have to be met and supervisors are required to determine whether the conditions have been met in each case. The proposal is to **keep the supervisory decision in its present form.**

2. **Drafting proposal:** No change necessary at the CRD level, but the provision should be implemented as a supervisory decision at the national level.

126. Securitisation, Annex IX, part 4, point 43, last sentence (Directive 2006/48/EC)

"The requirement for the assessment methodology of the ECAI to be publicly available may be waived by the competent authorities where they are satisfied that due to the specific features of the securitisation — for example its unique structure — there is as yet no publicly available ECAI assessment methodology"

1. **Reasoning and proposal:** This is not a national discretion but a supervisory decision exercised on a case by case basis by the competent authorities. The use of this supervisory decision is understood to be an exceptional measure: a securitisation structure often consists of different pools of assets for which a rating and a publicly available ECAI assessment methodology will normally exist. Exceptionally there might be cases of unusual asset classes that are part of the securitisation structure, for which no such ratings/assessment methodologies exist. It is for this exceptional situation that this supervisory decision was created. Therefore, the proposal is to **keep the supervisory decision in its present form**.

2. **Drafting proposal:** No change necessary at the CRD level, but the provision should be implemented as a supervisory decision at the national level.

127. Securitisation, Annex IX, Part 4, point 58 (Directive 2006/48/EC)

"When it is not practical for the credit institution to calculate the risk-weighted exposure amounts for the securitised exposures as if they had not been securitised, a credit institution may, on an exceptional basis and subject to the consent of the competent authorities, temporarily be allowed to apply the method set out in point 59 for the calculation of risk-weighted exposure amounts for an unrated securitisation position in the form of a liquidity facility that meets the conditions to be an 'eligible liquidity facility' set out in point 13 or that falls within the terms of point 56."

1. **Reasoning and proposal:** This is not a national discretion but a supervisory decision to be taken by competent authorities on a case by case basis if and when necessary. This is reflected in the wording of the provision: i.e. 'on an exceptional basis' and 'temporarily be allowed'), and it should thus be available to supervisors and cannot be a general rule. The proposal is to **keep the supervisory decision in its present form** and the Member States that have not yet implemented this provision as a supervisory decision to be used on a case by case basis should be urged to do so as soon as possible.

2. **Drafting proposal:** No change necessary at the CRD level, but the provision should be implemented as a supervisory decision at the national level.

128. Securitisation, Article 97.1 (Directive 2006/48/EC)

"An ECAI credit assessment may be used to determine the risk weight of a securitisation position in accordance with Article 96 only if the ECAI has been recognised as eligible by the competent authorities for this purpose (hereinafter 'an eligible ECAI')."

1. **Reasoning and proposal**: This is not a national discretion. It is a general rule stating that only ratings from recognized ECAIs are allowed to be used by any credit institution which chooses to do so when determining the securitisation position in accordance with article 96. The proposal is to **keep the possibility of using the ECAIs' credit assessment as an option for credit institutions**.

2. **Drafting proposal:** No change necessary since it is an option for credit institutions.

129. Securitisation, Article 97.2 (Directive 2006/48/EC)

"The competent authorities shall recognise an ECAI as eligible for the purposes of paragraph 1 only if they are satisfied as to its compliance with the requirements laid down in Article 81, taking into account the technical criteria in Annex VI, Part 2, and that it has a demonstrated ability in the area of securitisation, which may be evidenced by a strong market acceptance."

1. **Reasoning and proposal:** This is not a national discretion, it is a general rule stating the criteria for the recognition of the ECAIs for rating securitisation positions. The determination of whether these criteria have been met involves a case by case decision of the supervisor and, therefore, this is not a national discretion, but a supervisory decision. The proposal is to **keep the supervisory decision in its present form** and the Member States that have not yet implemented this provision as a supervisory decision to be used on a case by case basis should be urged to do so as soon as possible.

2. **Drafting proposal:** No change necessary at the CRD level, but the provision should be implemented as a supervisory decision at the national level.

130. Securitisation, Article 97.3 (Directive 2006/48/EC)

"If an ECAI has been recognised as eligible by the competent authorities of a Member State for the purposes of paragraph 1, the competent authorities of other Member States may recognise that ECAI as eligible for those purposes without carrying out their own evaluation process."

1. **Reasoning and proposal**: The CRD allows Member States to recognise an ECAI as eligible in two ways: direct recognition, in which the competent authority carries out its own assessment of the ECAI's compliance with the CRD's eligibility criteria; and indirect recognition in which the competent authority recognises the ECAI without carrying out its own evaluation, relying instead on the recognition of the ECAI by the competent authority of another

Member State. A common understanding of the recognition criteria and processes has been developed to support consistency in direct recognition decision-making across the EU and to increase the scope for indirect recognition (see CEBS Guidelines on the recognition of ECAIs released on 20 January 2006). Additionally, and in order to avoid the inefficiencies of sequential direct recognition processes in cases where applications from the same ECAI are received by a number of competent authorities, those competent authorities will participate in a 'joint assessment process' to assess together the ECAI's eligibility. Recognising that the CRD requires a decision by each competent authority, where a shared view is achieved, this should form the basis for national decision making. This is not a national discretion but a method for ensuring a harmonized approach. The proposal is to include in the CRD the **requirement for a joint assessment process.** Feedback received during the public consultation indicates that market participants welcome the joint assessment process, but also that they would like the outcome of this assessment to be binding on all supervisors. CEBS believes that this would result in a fundamental change to the existing allocation of tasks between CEBS and supervisors and more generally to the current supervisory framework. Such a change falls outside the mandate given by the European Commission and cannot thus be recommended by CEBS. CEBS also points out that the positive experience with the joint ECAI recognition process leads to the conclusion that the established process has positive consequences for the level of harmonisation.

2. **Drafting proposal:**

Before an ECAI is recognised as eligible for the purposes of 97.1, the competent authority shall invite all other competent authorities to whom an application has been made to participate in a joint assessment of the ECAI. If, as a result of the assessment process, an ECAI has been recognised as eligible for the purposes of paragraph 1 by any Member State, the competent authorities of other Member States may recognise that ECAI as eligible for those purposes without carrying out their own evaluation process.

131. Securitisation, Article 98.1 (Directive 2006/48/EC)

"For the purposes of applying risk weights to securitisation positions, the competent authorities shall determine with which of the credit quality steps set out in Annex IX the relevant credit assessments of an eligible ECAI are to be associated. Those determinations shall be objective and consistent."

1. **Reasoning and proposal:** The CRD requires a separate mapping of credit assessments of securitisation positions which follows the same principles of objectivity and consistency as the fundamentals mapping. The main reasons for this distinction are: first, securitisation transactions have unique characteristics, and the market is highly innovative and constantly evolving. Second, securitisation mapping under the Internal Risk Based (IRB) Approach should be more finely graduated than the mapping of general credit assessments under the Standardised Approach. This is not a national discretion but a method of ensuring a harmonized approach. The proposal is

to include in the CRD the **requirement for a joint assessment process.** Feedback received from the public consultation indicates that market participants welcome the joint assessment process, but also that they would like the outcome of this assessment to be binding to all supervisors. CEBS believes that this would result in a fundamental change to the existing allocation of tasks between CEBS and supervisors and more generally to the current supervisory framework. Such a change falls outside the mandate given by the European Commission and cannot thus be recommended by CEBS. CEBS also points out that the positive experience with the joint ECAI recognition process leads to the conclusion that the established process has positive consequences for the level of harmonisation.

2. **Drafting proposal**:

For the purposes of applying risk weights to securitisation positions, the competent authority shall determine with which of the credit quality steps set out in Annex IX the relevant credit assessments of an eligible ECAI are to be associated. Those determinations shall be objective and consistent. The competent authority shall invite all other competent authorities to whom an application has been made to participate in the joint process with the aim of determining with which of the credit quality steps set out in Annex IX the relevant credit assessments of an eligible ECAI are to be associated.

132. Securitisation, Article 98.2 (Directive 2006/48/EC)

"When the competent authorities of a Member State have made a determination under paragraph 1, the competent authorities of other Member States may recognise that determination without carrying out their own determination process."

1. **Reasoning and proposal:** This is not a national discretion. This is the **indirect recognition clause** corresponding to Article 98.1 (national discretion number 131). The CRD allows Member States to determine the securitisation mapping in two ways: directly, when the competent authority carries out its own determination process (which may be through a joint assessment process); or indirectly, when the competent authority relies on the determination process of a competent authority in another Member State. The latter would be the most natural decision when the ECAI is indirectly recognised according to article 97.3.

2. **Drafting proposal:** No change necessary because it is an indirect recognition clause.

Area: Standardised Approach

133. Standardised Approach, Annex VI, Part 1, point 29 (Directive 2006/48/EC)

"Exposures to institutions with an original effective maturity of more than three months for which a credit assessment by a nominated ECAI is available shall be assigned a risk weight according to Table 4 in accordance with the assignment by the competent authorities of the credit assessments of eligible ECAIs to six steps in a credit quality assessment scale".

See provision 135.

134. Standardised Approach, Annex VI, Part 1, point 31 (Directive 2006/48/EC)

"Exposures to an institution with an original effective maturity of three months or less for which a credit assessment by a nominated ECAI is available shall be assigned a risk weight according to Table 5 in accordance with the assignment by the competent authorities of the credit assessments of eligible ECAIs to six steps in a credit quality assessment scale"..

See provision 135.

135. Standardised Approach, Annex VI, Part 1, point 41 (Directive 2006/48/EC)

"Exposures for which a credit assessment by a nominated ECAI is available shall be assigned a risk weight according to Table 6 in accordance with the assignment by the competent authorities of the credit assessments of eligible ECAIs to six steps in a credit quality assessment scale".

1. **Reasoning and proposal:** None of these provisions is a national discretion; they are **general provisions** saying that the assignment of risk weights shall be based on the placement by the competent authorities of the credit assessments of eligible ECAIs on to six steps of a credit quality assessment scale. There are two corresponding mutual recognition clauses (see provisions 148 and 149) which introduce the possibility of a joint assessment/determination process to allow for a harmonised approach. To ensure this harmonized approach, the proposal is to include in the CRD the requirement for a joint assessment process, which accords with current practice.

2. **Drafting proposal**: No change necessary.

136. Standardised Approach, Annex VI, Part 1, point 49 (Directive 2006/48/EC)

"Competent authorities may dispense with the condition contained in point 48(b) for exposures fully and completely secured by mortgages on residential property which is situated within their territory, if they have evidence that a

well-developed and long-established residential real estate market is present in their territory with loss rates which are sufficiently low to justify such treatment".

Point 48(b): "the risk of the borrower does not materially depend upon the performance of the underlying property or project, but rather on the underlying capacity of the borrower to repay the debt from other sources. As such, repayment of the facility does not materially depend on any cash flow generated by the underlying property serving as collateral"

1. **Overview of exercise:** Based on the data reported for CEBS's mutual recognition exercise, 13 Member States (43%) have exercised this national discretion and 16 Member States (53%) have not exercised it.

2. **Reasoning and proposal:** This national discretion allows Member States to assign a reduced risk weight (35% instead of 100%) to exposures secured by mortgages on residential property which is situated within their territory, if the local market fulfils certain requirements. The exercise of this discretion is based on local market conditions. In qualifying exposures secured by mortgages on residential property for a 35% risk weight, the competent authorities may waive from the required criteria the condition that the risk of the borrower should not materially depend on the performance of the underlying property, if a well developed and long established market exists in the territory with sufficiently low loss rates to justify such treatment. In general only local supervisors are in a position to assess whether these preconditions are met in their local market in order to justify the application of the waiver. This national discretion is subject to an explicit mutual recognition clause (see provision 137)**.** As this national discretion is rooted in local market conditions, it is proposed to **keep this discretion in the present form** (see provision 137 for the level playing field proposal).

3. **Drafting proposal:** No changes necessary.

4. **Other remarks:** Competent authorities should fully disclose the manner of their exercise of this national discretion in the supervisory disclosure framework, if they do not do so already.

137. Standardised Approach, Annex VI, Part 1, point 50 (Directive 2006/48/EC)

"When the discretion contained in point 49 is exercised by the competent authorities of a Member State, the competent authorities of another Member State may allow their credit institutions to assign a risk weight of 35% to such exposures fully and completely secured by mortgages on residential property".

1. **Overview of exercise:** Based on the data disclosed under the supervisory disclosure framework, 15 Member States have exercised this mutual recognition (one with conditions, i.e. on a case by case basis). CEBS's stock take on mutual recognition of June 2007 indicated that 20 Member States will recognise other Member States' assessment in all cases; 5 only when the

relative importance of the specific subsidiary in the total group is low and consolidated solvency is not eroded, 4 only in other specific circumstances and 1 will not recognise them.

2. **Reasoning and proposal:** This national discretion allows a Member State to recognise the treatment by another Member State of certain exposures secured by mortgages on residential property. Exercising this mutual recognition clause results in a risk weight of 35% if the respective Member State has exercised the national discretion in point 49 and a risk weight of 100% if it has not exercised the national discretion in its jurisdiction. In general, local supervisors are in a better position to assess whether the market in its jurisdiction is well developed and long established and if loss rates are sufficiently low to justify the application of the waiver. As all Members currently disclosing their national transposition of this mutual recognition clause do exercise it and as the CEBS's stock take does show strong willingness to recognise the national treatment of such exposures, it is proposed to turn this non-binding mutual recognition into a **binding mutual recognition clause, but achieved through an option for credit institutions**.

3. **Drafting Proposal:**

When the discretion contained in point 49 is exercised by the competent authorities of a Member State, credit institutions may assign a risk weight of 35% to such exposures fully and completely secured by mortgages on residential property.

138. Standardised Approach, Annex VI, Part 1, point 51 (Directive 2006/48/EC)

"Subject to the discretion of the competent authorities, exposures or any part of an exposure fully and completely secured, to the satisfaction of the competent authorities, by mortgages on offices or other commercial premises situated within their territory may be assigned a risk weight of 50%.

1. **Overview of exercise:** Based on data reported for the mutual recognition exercise, 16 Member States (53%) have exercised this national discretion and 14 Member States (47%) have not exercised it.

2. **Reasoning and proposal:** This national discretion allows Member States to assign a reduced risk weight (50% instead of 100%) to (parts of) exposures secured by mortgages on offices or other commercial premises situated within their territory when certain conditions are met. The criteria for this lower risk weight are explicitly stated in Annex VI point 54. In general, local supervisors are in a better position to assess whether the local market conditions in its jurisdiction justify the exercise of this discretion. This national discretion is subject to an explicit mutual recognition clause (see provision 141). As this national discretion is rooted in local market conditions, it is proposed to **keep this discretion** in the present form. See provision 141 for the level playing field proposal.

3. **Drafting proposal:** No changes necessary.

4. **Other remarks:** Competent authorities should fully disclose the manner of their exercise of this national discretion in the supervisory disclosure framework, if they do not do so already.

139. Standardised Approach, Annex VI, Part 1, point 52 (Directive 2006/48/EC)

"Subject to the discretion of the competent authorities, exposures fully and completely secured, to the satisfaction of the competent authorities, by shares in Finnish housing companies, operating in accordance with the Finnish Housing Company Act of 1991 or subsequent equivalent legislation, in respect of offices or other commercial premises may be assigned a risk weight of 50%".

1. **Overview of exercise:** Based on the data gathered in the context of CEBS's work on mutual recognition. 12 Member States (40%) have exercised this national discretion and 16 Member States (53%) have not exercised it.

2. **Reasoning and proposal:** CEBS's view is that this provision is not intended to be a national discretion, but a supervisory decision to be applied on a case by case basis that should have been implemented by all Member States. This discretion allows Member States to assign a reduced risk weight (50% instead of 100%) to certain exposures secured by shares in Finnish housing companies when certain conditions are met. This discretion is directly related to the local, Finnish, conditions. The wording of the discretion suggests that each supervisor makes his own independent judgement on whether the conditions for applying the discretion are met. In practice, however, the application of this discretion (and mutual recognition) will very much depend on the assessment of the Finnish supervisor. It is highly unlikely that any supervisor would allow a 50% risk weight for an exposure that would not be allowed by the Finnish supervisor itself. It is in the best position to assess whether specific shares in Finnish housing companies operate within the Finnish Housing Company Act of 1991 or equivalent legislation in respect of offices and other commercial premises. If any other supervisor allows the lower risk weight it will probably depend on the decision of the Finnish supervisor. The local Finnish conditions are the relevant conditions to consider. In this context, the proposal is to **transform the national discretion into a supervisory decision by the competent authorities.** This discretion is subject to an explicit mutual recognition clause that should, given the following drafting proposal for point 52, be deleted (see provision 141).

3. **Drafting proposal**:

Exposures fully and completely secured, to the satisfaction of the competent authorities, by shares in Finnish housing companies, operating in accordance with the Finnish Housing Company Act of 1991 or subsequent equivalent legislation, in respect of offices and other commercial premises may be assigned a risk weight of 50%.

140. Standardised Approach, Annex VI, Part 1, point 53 (Directive 2006/48/EC)

"Subject to the discretion of the competent authorities, exposures related to property leasing transactions concerning offices or other commercial premises situated in their territories under which the credit institution is the lessor and the tenant has an option to purchase may be assigned a risk weight of 50% provided that the exposure of the credit institution is fully and completely secured to the satisfaction of the competent authorities by its ownership of the property".

1. **Overview of exercise:** Based on data reported for the mutual recognition exercise, 12 Member States (40%) have exercised this national discretion and 17 Member States (57%) have not exercised it.

2. **Reasoning and proposal:** This national discretion allows Member States to assign a reduced risk weight (50% instead of 100%) to certain exposures related to property leasing transactions for offices or other commercial premises situated in their territories when certain conditions are met. The criteria for this lower risk weight are explicitly stated in Annex VI point 54. In general, local supervisors are in a better position to assess whether the local market conditions in their jurisdictions justify the exercise of this discretion. This national discretion is subject to an explicit mutual recognition clause (see provision 141). As this national discretion is rooted in local market conditions, it is proposed to **keep this discretion in the present form**. See provision 141 for the level playing field proposal.

3. **Drafting proposal:** No change necessary.

4. **Other remarks:** Competent authorities should fully disclose the manner of exercise of this national discretion in the supervisory disclosure framework, if they do not do so already.

141. Standardised Approach, Annex VI, Part 1, point 57 (Directive 2006/48/EC)

"When the discretion contained in points 51 to 53 is exercised by the competent authorities of one Member State, the competent authorities of another Member State may allow their credit institutions to risk weight at 50% such exposures fully and completely secured by mortgages on commercial property".

1. **Overview of exercise:** Based on the information disclosed in the supervisory disclosure framework on national websites:

    - with reference to point 51: 15 Member States have exercised this mutual recognition (1 on a case by case basis), 1 Member State has not exercised this mutual recognition. CEBS's stock take in 2007 indicated that 21 Members support recognition in all cases, 5 support recognition,

under certain conditions and 1 opposes recognition given the general high risk character of commercial real estate collateral.

- with reference to point 52: 11 Member States have exercised this mutual recognition (1 on a case by case basis), 5 Member States have not exercised this mutual recognition. CEBS's stock take in 2007 indicated that 16 Members support recognition in all cases, 9 support recognition under certain conditions and 3 oppose recognition as it is deemed not relevant for their 'own' institutions and as such was not required during national implementation.

- with reference to point 53: 13 Member States have exercised this mutual recognition (1 on a case by case basis), 3 Member States have not exercised this mutual recognition. CEBS's stock take in 2007 indicated that 21 Members support recognition in all cases, and 9 support recognition under certain conditions.

2. **Reasoning and proposal:**

- with reference to point 51 (see provision 138): This national discretion allows a Member State to recognise the treatment by another Member States of certain exposures secured by mortgages on offices or other commercial premises situated within that Member State, i.e. irrespective of whether or not the national discretion contained in point 51 is exercised in the Member State itself. When exercising this mutual recognition clause, the treatment by another Member State is recognised for such exposures in that Member State.

- with reference to point 52 (see provision 139): The proposal to delete the second supervisory decision in point 52 and transform it into a discretion for the competent authorities (see provision 139) would imply **the deletion of the mutual recognition clause**.

- with reference to point 53 (see provision 140): This national discretion allows a Member State to recognise the treatment by another Member State of certain leasing transactions concerning offices or other commercial premises situated in its territory, i.e. irrespective of whether or not the national discretion contained in point 53 is exercised in the Member State itself. When exercising this mutual recognition clause, the treatment by another Member State is recognised for such exposures in that Member State.

As the majority of Member States currently disclosing their national transposition of the mutual recognition clauses do exercise them and as the stock take does show strong willingness to recognise the national treatment of such exposures, it is proposed to turn the mutual recognition clauses in points 51 and 53 into **options for credit institutions** (thus turning them in effect into binding mutual recognition clauses).

3. **Drafting Proposal:**

with reference to point 51: When the discretion contained in point 51 is exercised by the competent authorities of a Member State, credit institutions may assign a risk weight of 50% to such exposures fully and completely secured by mortgages on offices or other commercial premises.

with reference to point 52: delete the reference to point 52

with reference to point 53: When the discretion contained in point 53 is exercised by the competent authorities of a Member State, credit institutions may assign a risk weight of 50% to such exposures related to property leasing transactions concerning offices or other commercial premises.

142. Standardised Approach, Annex VI, Part 1, point 58 (Directive 2006/48/EC)

"Competent authorities may dispense with the condition contained in point 54(b) for exposures fully and completely secured by mortgages on commercial property which is situated within their territory, if they have evidence that a well-developed and long-established commercial real estate market is present in their territory with loss-rates which do not exceed the following limits:

(a) losses stemming from lending collateralised by commercial real estate property up to 50% of the market value (or where applicable and if lower 60% of the mortgage lending value (MLV)) do not exceed 0,3% of the outstanding loans collateralised by commercial real estate property in any given year; and

(b) overall losses stemming from lending collateralised by commercial real estate property must not exceed 0,5% of the outstanding loans collateralised by commercial real estate property in any given year".

Point 54(b): "the risk of the borrower must not materially depend upon the performance of the underlying property or project, but rather on the underlying capacity of the borrower to repay the debt from other sources. As such, repayment of the facility must not materially depend on any cash flow generated by the underlying property serving as collateral"

1. **Overview of exercise:** Based on data reported for the mutual recognition exercise, 7 Member States (23%) have exercised this national discretion and 22 Member States (73%) have not exercised it.

2. **Reasoning and proposal:** In qualifying exposures secured by mortgages on commercial property for a 50% risk weight, the competent authorities may waive from the required criteria the condition that the risk of the borrower should not materially depend on the performance of the underlying property if a well developed and long established market exists in the territory with sufficiently low loss rates to justify such treatment. In general only local supervisors are in a position to assess whether these preconditions are met in their local market to justify the application of the waiver. This national discretion is subject to an explicit mutual recognition clause (see provision 143). As this national discretion is rooted in local market conditions, it is

proposed to **keep this discretion in the present form.** See provision 143 for the level playing field proposal.

3. **Drafting proposal:** No change necessary.

4. **Other remarks:** Competent authorities should fully disclose the manner of their exercise of this national discretion in the supervisory disclosure framework, if they do not do so already.

143. Standardised Approach, Annex VI, Part 1, point 60 (Directive 2006/48/EC)

"When the discretion contained in point 58 is exercised by the competent authorities of a Member State, the competent authorities of another Member State may allow their credit institutions to assign a risk weight of 50% to such exposures fully and completely secured by mortgages on commercial property".

1. **Overview of exercise:** Based on the information on mutual recognition included in the supervisory disclosure framework on national websites, 15 Member States have exercised this mutual recognition (1 on a case by case basis), and 1 Member State has not exercised this mutual recognition. CEBS's stock take of June 2007 indicated that 18 Member Sates will recognise other Member States' assessment in all cases, 6 only when the relative importance of the specific subsidiary in the total group is low and consolidated solvency is not eroded, 4 only in other specific circumstances and *2* will not recognise it.

2. **Reasoning and proposal:** This national discretion allows Member States to recognise the treatment of certain exposures secured by mortgages on commercial property by another Member State. In general, local supervisors are in a better position to assess whether the local market in its jurisdiction is well developed and long established enough and if loss rates are sufficiently low to justify the application of the waiver. Exercising this mutual recognition clause results in a risk weight of 50% if the respective Member State has exercised the national discretion in point 58 and a risk weight of 100% if it has not exercised the national discretion in its jurisdiction. [Example: a Member State that has not exercised the national discretion (risk weight = 100% for exposures secured by mortgages on local commercial property) recognises the reduced risk weight for exposures secured by mortgages on commercial property in another Member State that has exercised the national discretion.] As the majority of Member States currently disclosing their national transposition of this mutual recognition do exercise it and as the stock take does show strong willingness to recognise the national treatment of such exposures, it is proposed to turn this non-binding mutual recognition into a **binding mutual recognition clause, but achieved through an option for credit institutions.**

3. **Drafting Proposal:**

When the discretion contained in point 58 is exercised by the competent authorities of a Member State, credit institutions may assign a risk weight of

50% to such exposures fully and completely secured by mortgages on commercial property.

144. Standardised Approach, Annex VI, Part 1, point 77(a) (Directive 2006/48/EC)

"Credit institutions may determine the risk weight for a CIU as set out in points 79 to 81, if the following eligibility criteria are met:

(a) the CIU is managed by a company which is subject to supervision in a Member State or, subject to approval of the credit institution's competent authority, if:

(i) the CIU is managed by a company which is subject to supervision that is considered equivalent to that laid down in Community law; and

(ii) cooperation between competent authorities is sufficiently ensured"

1. **Reasoning and proposal:** In CEBS's view, this provision **is not intended to be a national discretion, but a supervisory decision as to whether all preconditions are fully met in the individual approval process** (i.e. to be applied on a case by case basis). The provision should have been implemented by all Member States (the provision says "the competent authority may determine" and not the Member States) and also applied as such. The text of the Directive should be kept unchanged and the Member States that have not yet implemented this provision as a supervisory decision to be used on a case by case basis should be urged to do so as soon as possible. The condition sub ii) cannot be given to credit institutions as they do not have the relevant information. As a result, it would be no use to give the option under (i) to the credit institutions, as the approval will be the same. The corresponding mutual recognition clause in provision 145 introduces the possibility of a joint assessment process to help produce a harmonised approach.

2. **Drafting proposal:** No change necessary at the CRD level, but the provision should be implemented as a supervisory decision at the national level.

145. Standardised Approach, Annex VI, Part 1, point 78 (Directive 2006/48/EC)

"If a competent authority approves a third country CIU as eligible, as set out in point 77(a), then a competent authority in another Member State may make use of this recognition without conducting its own assessment".

1. **Overview of exercise:** Based on the information on mutual recognition included in the supervisory disclosure framework on national websites, 13 Member States have exercised this mutual recognition (1 on a case by case basis), 3 Member States have not exercised this mutual recognition

2. **Reasoning and proposal:** This provision is not a national discretion but a mutual recognition clause. When the competent authorities of another Member State have already recognised a certain third country CIU as eligible, a Member State does not need to carry out its own recognition process which simplifies the recognition process of third country CIUs. The decision, whether to carry out their own recognition process or not has to be decided by the national authorities on a case by case basis. Even if all Member States exercise this mutual recognition this provision cannot be turned into general rule. The proposal is to **keep this mutual recognition clause in the present form**. However, the possibility of **a joint assessment process** involving all supervisors that wish to participate (similar to the ECAI recognition process) should be considered. The outcome of the joint assessment process could be a public list of eligible third country CIUs that would provide a strong common basis on which national competent authorities would form their decisions. Feedback received in the public consultation indicates that market participants welcome the joint assessment process, but also that they would like the outcome of this assessment to be binding to all supervisors. CEBS believes that this would result in a fundamental change to the existing allocation of tasks between CEBS and supervisors and more generally to the current supervisory framework. Such a change falls outside the mandate given by the European Commission and cannot thus be recommended by CEBS. CEBS also points out that the positive experience with the ECAI recognition process leads to the conclusion that the established process has positive consequences for the level of harmonisation.
3. **Drafting proposal:** No change necessary.

146. Standardised Approach, Article 81.1 (Directive 2006/48/EC)

"An external credit assessment may be used to determine the risk weight of an exposure in accordance with Article 80 only if the ECAI which provides it has been recognised as eligible for those purposes by the competent authorities ('an eligible ECAI' for the purposes of this Subsection)".

See provision 147.

147. Standardised Approach, Article 81.2 (Directive 2006/48/EC)

"Competent authorities shall recognise an ECAI as eligible for the purposes of Article 80 only if they are satisfied that its assessment methodology complies with the requirements of objectivity, independence, ongoing review and transparency, and that the resulting credit assessments meet the requirements of credibility and transparency. For those purposes, the competent authorities shall take into account the technical criteria set out in Annex VI, Part 2".

1. **Reasoning and proposal**: Provisions 146 and 147 are not a national discretion; they are **general provisions** saying that only the ratings of recognised ECAIs shall be used (No 146) and under which conditions an ECAI

can be recognised as eligible by the competent authority (provision147). The corresponding indirect mutual recognition clause in provision 148 introduces the possibility of a joint assessment process by all supervisors to whom an application has been made to help produce a harmonised approach.

2. **Drafting proposal:** No change necessary.

148. Standardised Approach, Article 81.3 (Directive 2006/48/EC)

"If an ECAI has been recognised as eligible by the competent authorities of a Member State, the competent authorities of other Member States may recognise that ECAI as eligible without carrying out their own evaluation process".

1. **Overview of exercise:** Based on the mutual recognition data disclosed under the supervisory disclosure framework, 16 Member States have exercised this mutual recognition (2 on a case by case basis).

2. **Reasoning and proposal:** This provision is not a national discretion but an **indirect recognition clause** that allows Member States to abstain from carrying out an evaluation process of their own which simplifies the recognition process of eligible ECAIs. When the competent authorities of another Member State have already recognised a certain ECAI as eligible, a Member State does not need to carry out its own evaluation process. The decision, whether to carry out their own evaluation process or not has to be decided by the national authorities on a case by case basis. Even if all Member States do exercise this mutual recognition, the discretion cannot be turned into general rule. The proposal is to **keep this indirect recognition clause in the present form**. It should be noted that there is in place an **EU joint assessment process,** in the context of the CEBS, in which competent authorities to whom the ECAI has applied are invited to participate with the intention of reaching a consensus view that would provide a strong common basis on which national competent authorities would form their decisions. Feedback received in the public consultation indicates that market participants welcome the joint assessment process, but also that they would like the outcome of this assessment to be binding to all supervisors. CEBS believes that this would result in a fundamental change to the existing allocation of tasks between CEBS and supervisors and more generally to the current supervisory framework. Such a change falls outside the mandate given by the European Commission and cannot thus be recommended by CEBS. CEBS also points out that the positive experience with the joint ECAI recognition process leads to the conclusion that the established process has positive consequences for the level of harmonisation.

3. **Drafting proposal:** No change necessary.

149. Standardised Approach, Article 82.2 (Directive 2006/48/EC)

"When the competent authorities of a Member State have made a determination under paragraph 1, the competent authorities of other Member States may recognise that determination without carrying out their own determination process".

1. **Overview of exercise:** Based on the mutual recognition data disclosed under the supervisory disclosure framework, 16 Member States have exercised this mutual recognition (2 on a case by case basis).

2. **Reasoning and proposal:** This provision is not a national discretion but an indirect recognition clause. When the competent authorities of another Member State have mapped the credit assessments of an eligible ECAI to the credit quality steps set out in the CRD, a Member does not need to carry out its own determination process which simplifies the mapping process of eligible ECAIs. The decision, whether to carry out their own determination process or not has to be decided by the national authorities on a case by case basis. Even if all Member States do exercise this mutual recognition, the discretion cannot be turned into general rule and, since it concerns an individual evaluation of an institution, binding mutual recognition does not seem appropriate. It is proposed to **keep this indirect recognition clause in the present form**. It should be noted that is in place an **EU joint assessment process,** in the context of the CEBS, in which competent authorities to whom the ECAI has applied are invited to participate with the intention of reaching a consensus view that would provide a strong common basis on which national competent authorities would form their decisions. Feedback received in the public consultation indicates that market participants welcome the joint assessment process, but also that they would like the outcome of this assessment to be binding to all supervisors. CEBS believes that this would result in a fundamental change to the existing allocation of tasks between CEBS and supervisors and more generally to the current supervisory framework. Such a change falls outside the mandate given by the European Commission and cannot thus be recommended by CEBS. CEBS also points out that the positive experience with the joint ECAI recognition process leads to the conclusion that the established process has positive consequences for the level of harmonisation.

3. **Drafting proposal:** No change necessary.

Area: Transitional provisions

150. Transitional provisions, Article 154.1, second paragraph (Directive 2006/48/EC)

"Competent authorities which do not exercise the discretion provided for in the first subparagraph in relation to exposures to counterparties situated in their territory may set a higher number of days for exposures to counterparties situated in the territories of other Member States, the competent authorities of which have exercised that discretion. The specific number shall fall within 90 days and such figures as the other competent authorities have set for exposures to such counterparties within their territory."

1. **Reasoning and proposal**: This provision allows competent authorities to apply mutual recognition of the transitional use of a different definition of past due (SA) as defined by national discretion 70. This clause determines the possibility of mutual recognition and, therefore, should not be treated as a separate national discretion but analysed in conjunction with national discretion 70. Due to the short expiry date it is proposed to **keep this mutual recognition clause in the present form.** This is proposed for all transitional national discretions which expire before the end of 2011, in view of time needed for any legislative process and the maximum (very short) remaining use of the provision thereafter.

2. **Drafting proposal:** No change is necessary. The provision should be deleted at the end of its validity.

151. Transitional provisions, Article 154.7, first two sentences (Directive 2006/48/EC)

"Until 31 December 2011, for corporate exposures, the competent authorities of each Member State may set the number of days past due that all credit institutions in its jurisdiction shall abide by under the definition of 'default' set out in Annex VII, Part 4, point 44 for exposures to such counterparts situated within this Member State. The specific number shall fall within 90 up to a figure of 180 days if local conditions make it appropriate."

1. **Reasoning and proposal**: This provision allows more permissive transitional treatment of past due items for corporate exposures (IRB). According to the views expressed by industry representatives, additional clarification on this discretion is necessary - to clarify that after the transition period there is no longer any exception to the 90 days past due and to clarify that banks with subsidiaries in the countries with longer past due periods have the choice on whether to use for these subsidiaries the home or the local past due definition. It should be noted that the current CRD text clearly indicates the expiration date of the provision, i.e. it will not be valid after 31 December 2011. This provision should be considered together with provision 152. Given the short time before its expiry date it is proposed to **keep it in the present form.** This is proposed for all transitional national discretions which expire before the end of 2011 in view of time needed for any legislative process and the maximum (very short) remaining use of the provision thereafter.

2. **Drafting proposal:** No change is necessary. The provision should be deleted at the end of its validity.

152. Transitional provisions, Article 154.7, last sentence (Directive 2006/48/EC)

"For exposures to such counterparts situated in the territories of other Member States, the competent authorities shall set a number of days past due which is

not higher than the number set by the competent authority of the respective Member State."

1. **Reasoning and proposal:** This provision allows mutual recognition of days past due for corporate exposures (IRB) as defined in provision 151.

2. **Drafting proposal:** No change is necessary. The provision should be deleted at the end of its validity. **See provision 151.**