

COUNCIL DIRECTIVE
of 17 April 1989
on the own funds of credit institutions
(89/299/EEC)

THE COUNCIL OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community, and in particular the first and third sentences of Article 57 (2) thereof,

Having regard to the proposal from the Commission ⁽¹⁾,

In cooperation with the European Parliament ⁽²⁾,

Having regard to the opinion of the Economic and Social Committee ⁽³⁾,

Whereas common basic standards for the own funds of credit institutions are a key factor in the creation of an internal market in the banking sector since own funds serve to ensure the continuity of credit institutions and to protect savings; whereas such harmonization will strengthen the supervision of credit institutions and contribute to further coordination in the banking sector, in particular the supervision of major risks and solvency ratios;

Whereas such standards must apply to all credit institutions authorized in the Community;

Whereas the own funds of a credit institution can serve to absorb losses which are not matched by a sufficient volume of profits; whereas the own funds also serve as an important yardstick for the competent authorities, in particular for the assessment of the solvency of credit institutions and for other prudential purposes;

Whereas credit institutions in a common banking market engage in direct competition with each other, and the definitions and standards pertaining to own funds must therefore be equivalent; whereas, to that end, the criteria for determining the composition of own funds must not be left solely to Member States; whereas the adoption of common basic standards will be in the best interests of the Community in that it will prevent distortions of competition and will strengthen the Community banking system;

Whereas the definition laid down in this Directive provides for a maximum of items and qualifying amounts, leaving it to the discretion of each Member State to use all or some of such items or to adopt lower ceilings for the qualifying amounts;

Whereas this Directive specifies the qualifying criteria for certain own funds items, and the Member States remain free to apply more stringent provisions;

Whereas at the initial stage common basic standards are defined in broad terms in order to encompass all the items making up own funds in the different Member States;

Whereas, according to the nature of the items making up own funds, this Directive distinguishes between on the one hand, items constituting original own funds and, on the other, those constituting additional own funds; ...

Whereas it is recognized that due to the special nature of the fund for general banking risks, this item is to be included provisionally in own funds without limit; whereas, however, a decision on its final treatment will have to be taken as soon as possible after the implementation of the Directive; whereas that decision will have to take into account the results of discussions in international fora;

Whereas, to reflect the fact that items constituting additional own funds are not of the same nature as those constituting original own funds, the amount of the former included in own funds must not exceed the original own funds; whereas, moreover, the amount of certain items of additional own funds included must not exceed one-half of the original own funds;

Whereas, in order to avoid distortions of competition, public credit institutions must not include in their own funds guarantees granted them by the Member States or local authorities; whereas, however, the Kingdom of Belgium should be granted a transitional period up to 31 December 1994 in order to permit the institutions concerned to adjust to the new conditions by reforming their statutes;

Whereas whenever in the course of supervision it is necessary to determine the amount of the consolidated own funds of a group of credit institutions, that calculation shall be effected in accordance with Council Directive 83/350/EEC of 13 June 1983 on the supervision of credit institutions on a consolidated basis ⁽⁴⁾; whereas that Directive leaves the Member States scope to interpret the technical details of its application, and that scope should be in keeping with the spirit of this Directive; whereas the former Directive is currently being revised to achieve greater harmonization;

⁽¹⁾ OJ No C 243, 27. 9. 1986, p. 4 and OJ No C 32, 5. 2. 1988, p. 2.

⁽²⁾ OJ No C 246, 14. 9. 1987, p. 72 and OJ No C 96, 17. 4. 1989.

⁽³⁾ OJ No C 180, 8. 7. 1987, p. 51.

⁽⁴⁾ OJ No L 193, 18. 7. 1983, p. 18.

Whereas the precise accounting technique to be used for the calculation of own funds must take account of the provisions of Council Directive 86/635/EEC of 8 December 1986 on the annual accounts and consolidated accounts of banks and other financial institutions⁽¹⁾, which incorporates certain adaptations of the provisions of Council Directive 83/349/EEC of 13 June 1983 based on Article 54 (3) (g) of the Treaty on consolidated accounts⁽²⁾; whereas pending transposition of the provisions of the abovementioned Directives into the national laws of the Member States, the use of a specific accounting technique for the calculation of own funds should be left to the discretion of the Member States;

Whereas this Directive forms part of the wider international effort to bring about approximation of the rules in force in major countries regarding the adequacy of own funds;

Whereas measures to comply with the definitions in this Directive must be adopted no later than the date of entry into force of the measures implementing the future directive harmonizing solvency ratios;

Whereas the Commission will draw up a report and periodically examine this Directive with the aim of tightening its provisions and thus achieving greater convergence on a common definition of own funds; whereas such convergence will allow the alignment of Community credit institutions' own funds;

Whereas it will probably be necessary to make certain technical and terminological adjustments to the directive to take account of the rapid development of financial markets; whereas pending submission by the Commission of a proposal which takes account of the special characteristics of the banking sector and which permits the introduction of a more suitable procedure for the implementation of this Directive, the Council reserves the right to take such measures.

HAS ADOPTED THIS DIRECTIVE:

Article 1

Scope

1. Wherever a Member State lays down by law, regulation or administrative action a provision in implementation of Community legislation concerning the prudential supervision of an operative credit institution which uses the term or refers to the concept of own funds, it

shall bring this term or concept into line with the definition given in the following Articles.

2. For the purposes of this Directive, 'credit institutions' shall mean the institutions to which Directive 77/780/EEC⁽³⁾, as last amended by Directive 86/524/EEC⁽⁴⁾, applies.

Article 2

General principles

1. Subject to the limits imposed in Article 6, the unconsolidated own funds of credit institutions shall consist of the following items:

- (1) capital within the meaning of Article 22 of Directive 86/635/EEC, in so far as it has been paid up, plus share premium accounts but excluding cumulative preferential shares;
- (2) 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. 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;
- (3) revaluation reserves within the meaning of Article 33 of Council Directive 78/660/EEC of 25 July 1978 based on Article 54 (3) (g) of the Treaty on the annual accounts of certain types of companies⁽⁵⁾, as last amended by Directive 84/569/EEC⁽⁶⁾;
- (4) funds for general banking risks within the meaning of Article 38 of Directive 86/635/EEC;
- (5) value adjustments within the meaning of Article 37 (2) of Directive 86/635/EEC;
- (6) other items within the meaning of Article 3;
- (7) the commitments of the members of credit institutions set up as cooperative societies and the joint and several commitments of the borrowers of certain institutions organized as funds, as referred to in Article 4 (1);
- (8) fixed-term cumulative preferential shares and subordinated loan capital as referred to in Article 4 (3).

⁽³⁾ OJ No L 322, 17. 12. 1977, p. 30.

⁽⁴⁾ OJ No L 309, 4. 11. 1986, p. 15.

⁽⁵⁾ OJ No L 222, 14. 8. 1978, p. 11.

⁽⁶⁾ OJ No L 314, 4. 12. 1984, p. 28.

⁽¹⁾ OJ No L 372, 31. 12. 1986, p. 1.

⁽²⁾ OJ No L 193, 18. 7. 1983, p. 1.

The following items shall be deducted in accordance with Article 6:

- (9) own shares at book value held by a credit institution;
- (10) intangible assets within the meaning of Article 4 (9) ('assets') of Directive 86/635/EEC;
- (11) material losses of the current financial year;
- (12) holdings in other credit and financial institutions amounting to more than 10% of their capital, subordinated claims and the instruments referred to in Article 3 which a credit institution holds in respect of credit and financial institutions in which it has holdings exceeding 10% of the capital in each case.

Where shares in another credit or financial institution are held temporarily for the purposes of a financial assistance operation designed to reorganize and save that institution, the supervisory authority may waive this provision;

- (13) holdings in other credit and financial institutions of up to 10% of their capital, the subordinated claims and the instruments referred to in Article 3 which a credit institution holds in respect of credit and financial institutions other than those referred to in point 12 in respect of the amount of the total of such holdings, subordinated claims and instruments which exceed 10% of that credit institution's own funds calculated before the deduction of items 12 and 13.

Pending subsequent coordination of the provisions on consolidation, Member States may provide that, for the calculation of unconsolidated own funds, parent companies subject to supervision on a consolidated basis need not deduct their holdings in other credit institutions or financial institutions which are included in the consolidation. This provision shall apply to all the prudential rules harmonized by Community acts.

2. The concept of own funds as defined in points 1 to 8 of paragraph 1 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 items 9 to 13 of paragraph 1 shall be left to the discretion of the Member States. Member States shall nevertheless be obliged to consider increased convergence with a view to a common definition of own funds.

To that end, the Commission shall, not more than three years after the date referred to in Article 9 (1), submit a report to the European Parliament and to the Council on the application of this Directive, accompanied, where appropriate, by such proposals for amendment as it shall deem necessary. Within five years of the date referred to in Article 9 (1), the Council shall, acting by qualified majority on a proposal from the Commission, in cooperation with the European Parliament and after consultation of the Economic

and Social Committee, examine the definition of own funds with a view to the uniform application of the common definition.

3. The items listed in points 1 to 5 must be available to a credit institution for unrestricted and immediate use to cover risks or losses as soon as these occur. The amount must be net of any foreseeable tax charge at the moment of its calculation or be suitably adjusted in so far as such tax charges reduce the amount up to which these items may be applied to cover risks or losses.

Article 3

Other items referred to in Article 2 (1) (6)

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:

- (a) they are freely available to the credit institution to cover normal banking risks where revenue or capital losses have not yet been identified;
- (b) their existence is disclosed in internal accounting records;
- (c) their amount is determined by the management of the credit institution, verified by independent auditors, made known to the competent authorities and placed under the supervision of the latter. With regard to verification, internal auditing may be considered as provisionally meeting the aforementioned requirements until such time as the Community provisions making external auditing mandatory have been implemented.

2. Securities of indeterminate duration and other instruments that fulfil the following conditions may also be accepted as other items:

- (a) they may not be reimbursed on the bearer's initiative or without the prior agreement of the supervisory authority;
- (b) the debt agreement must provide for the credit institution to have the option of deferring the payment of interest on the debt;
- (c) the lender's claims on the credit institution must be wholly subordinated to those of all non-subordinated creditors;
- (d) the documents governing the issue of the securities must provide for debt and unpaid interest to be such as to absorb losses, whilst leaving the credit institution in a position to continue trading;
- (e) only fully paid-up amounts shall be taken into account.

To these may be added cumulative preferential shares other than those referred to in Article 2 (1) (8).

Article 4

1. The commitments of the members of credit institutions set up as cooperative societies referred to in Article 2 (1) (7), shall comprise those societies' uncalled capital, together with the legal commitments of the members of those cooperative societies to make additional non-refundable payments should the credit institution incur a loss, in which case it must be possible to demand those payments without delay.

The joint and several commitments of borrowers in the case of credit institutions organized as funds shall be treated in the same way as the preceding items.

All such items may be included in own funds in so far as they are counted as the own funds of institutions of this category under national law.

2. Member States shall not include in the own funds of public credit institutions guarantees which they or their local authorities extend to such entities.

However, the Kingdom of Belgium shall be exempt from this obligation until 31 December 1994.

3. Member States or the competent authorities may include fixed-term cumulative preferential shares referred to in Article 2 (1) (8) and subordinated loan capital referred to in that provision in own funds, if binding agreements exist under which, in the event of the bankruptcy or liquidation of the credit institution, they rank after the claims of all other creditors and are not to be repaid until all other debts outstanding at the time have been settled.

Subordinated loan capital must also fulfil the following criteria:

- (a) only fully paid-up funds may be taken into account;
- (b) the loans involved must have an original maturity of at least five years, after which they may be repaid; if the maturity of the debt is not fixed, they shall be repayable only subject to five years' notice unless the loans are no longer considered as own funds or unless the prior consent of the competent authorities is specifically required for early repayment. The competent authorities may grant permission for the early repayment of such loans provided the request is made at the initiative of the issuer and the solvency of the credit institution in question is not affected;
- (c) the extent to which they may rank as own funds must be gradually reduced during at least the last five years before the repayment date;
- (d) the loan agreement must not include any clause providing that in specified circumstances, other than the winding up of the credit institution, the debt will become repayable before the agreed repayment date.

Article 5

Until further coordination of the provisions on consolidation, the following rules shall apply.

1. Where the calculation is to be made on a consolidated basis, the consolidated amounts relating to the items listed under Article 2 (1) shall be used in accordance with the rules laid down in Directive 83/350/EEC. Moreover, the following may, when they are credit ('negative') items, be regarded as consolidated reserves for the calculation of own funds:
 - any minority interests within the meaning of Article 21 of Directive 83/349/EEC, where the global integration method is used,
 - the first consolidation difference within the meaning of Articles 19, 30 and 31 of Directive 83/349/EEC,
 - the translation differences included in consolidated reserves in accordance with Article 39 (6) of Directive 86/635/EEC,
 - any difference resulting from the inclusion of certain participating interests in accordance with the method prescribed in Article 33 of Directive 83/349/EEC.
2. Where the above are debit ('positive') items, they must be deducted in the calculation of consolidated own funds.

*Article 6***Deductions and limits**

1. The items referred to in Article 2 (1), points 3 and 5 to 8, shall be subject to the following limits:
 - (a) the total of items 3 and 5 to 8 may not exceed a maximum of 100% of items 1 plus 2 minus 9, 10 and 11;
 - (b) the total of items 7 and 8 may not exceed a maximum of 50% of items 1 plus 2 minus 9, 10 and 11;
 - (c) the total of items 12 and 13 shall be deducted from the total of all items.
2. The item referred to in Article 2 (1) (4) shall constitute a separate category. Provisionally, it shall be included in own funds without limit, but shall not be included when the basis of the limit for the items referred to in points 3 and 5 to 8 is fixed. Within six months of the implementation of this Directive the Commission shall, in accordance with the procedure provided for in Article 8, propose the final treatment for this item either in original own funds or in additional own funds.
3. The limits referred to in paragraph 1 must be complied with as from the date of the entry into force of the implementing measures for the Council Directive on a solvency ratio for credit institutions and by 1 January 1993 at the latest.

Credit institutions exceeding those limits must gradually reduce the extent to which the items referred to in Article 2 (1), points 3 and 5 to 8, are taken into account so that they comply with those limits before the aforementioned date.

4. The competent authorities may authorize credit institutions to exceed the limit laid down in paragraph 1 in temporary and exceptional circumstances.

Article 7

Compliance with the conditions laid down in Articles 2 to 6 must be proved to the satisfaction of the competent authorities.

Article 8

Without prejudice to the report referred to in Article 2 (2), second subparagraph, technical adaptations deemed to be necessary to this Directive to:

- clarify the definitions to ensure uniform application of the said Directive throughout the Community,
- clarify the definitions to take account, in implementing the said Directive, of developments on the financial markets,
- bring the terminology and wording of the definitions into line with that of subsequent acts concerning credit institutions and related areas,

shall be adopted by the Council acting by a qualified majority on a Commission proposal.

Article 9

1. Member States shall bring into force the laws, regulations and administrative provisions necessary for them to comply with this Directive no later than the date laid down for the entry into force of the implementing measures of the Council directive on a solvency ratio for credit institutions, and by 1 January 1993 at the latest. They shall forthwith inform the Commission thereof.

2. Member States shall communicate to the Commission the texts of the main provisions of national law which they adopt in the field governed by this Directive.

3. The communication referred to in paragraph 2 must also include a statement, accompanied by an explanatory text, notifying the Commission of the specific provisions adopted and the items selected by the Member States' respective competent authorities as comprising own funds.

Article 10

This Directive is addressed to the Member States.

Done at Luxembourg, 17 April 1989.

For the Council

The President

C. SOLCHAGA CATALAN