

Directive 2006/48/EC of the European Parliament and of the council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast) (Text with EEA relevance) (repealed)

TITLE V

**PRINCIPLES AND TECHNICAL INSTRUMENTS FOR  
PRUDENTIAL SUPERVISION AND DISCLOSURE**

CHAPTER 2

*Technical instruments of prudential supervision*

*Section 1*

***Own funds***

*Article 56*

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 Articles 57 to 61 and Articles 63 to 66.

*Article 57*

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

- (a) 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;
- (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;
- (c) funds for general banking risks within the meaning of Article 38 of Directive 86/635/EEC;
- (d) revaluation reserves within the meaning of Article 33 of Directive 78/660/EEC;
- (e) value adjustments within the meaning of Article 37(2) of Directive 86/635/EEC;
- (f) other items within the meaning of Article 63;
- (g) 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 organised as funds, as referred to in Article 64(1); and
- (h) fixed-term cumulative preferential shares and subordinated loan capital as referred to in Article 64(3).

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The following items shall be deducted in accordance with Article 66:

- (i) own shares at book value held by a credit institution;
- (j) intangible assets within the meaning of Article 4(9) ('Assets') of Directive 86/635/EEC;
- (k) material losses of the current financial year;
- (l) holdings in other credit and financial institutions amounting to more than 10 % of their capital;
- (m) subordinated claims and instruments referred to in Article 63 and Article 64(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;
- (n) holdings in other credit and financial institutions of up to 10 % of their capital, the subordinated claims and the instruments referred to in Article 63 and Article 64(3) which a credit institution holds in respect of credit and financial institutions other than those referred to in points (l) and (m) 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 in points (l) to (p);
- (o) participations within the meaning of Article 4(10) which a credit institution holds in:
  - (i) insurance undertakings within the meaning of Article 6 of Directive 73/239/EEC<sup>(1)</sup>, Article 4 of Directive 2002/83/EC<sup>(2)</sup> or Article 1(b) of Directive 98/78/EC<sup>(3)</sup>,
  - (ii) reinsurance undertakings within the meaning of Article 1(c) of Directive 98/78/EC, or
  - (iii) insurance holding companies within the meaning of Article 1(i) of Directive 98/78/EC;
- (p) each of the following items which the credit institution holds in respect of the entities defined in point (o) in which it holds a participation:
  - (i) instruments referred to in Article 16(3) of Directive 73/239/EEC, and
  - (ii) instruments referred to in Article 27(3) of Directive 2002/83/EC;
- (q) for credit institutions calculating risk-weighted exposure amounts under Section 3, Subsection 2, negative amounts resulting from the calculation in Annex VII, Part 1, point 36 and expected loss amounts calculated in accordance with Annex VII, Part 1 points 32 and 33; and
- (r) the exposure amount of securitisation positions which receive a risk weight of 1 250 % under Annex IX, Part 4, calculated in the manner there specified.

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.

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In the case of a credit institution which is the originator of a securitisation, net gains arising from the capitalisation of future income from the securitised assets and providing credit enhancement to positions in the securitisation shall be excluded from the item specified in point (b).

#### *Article 58*

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.

#### *Article 59*

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.

#### *Article 60*

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.

This provision shall apply to all the prudential rules harmonised by Community acts.

#### *Article 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.

The items listed in points (a) to (e) of Article 57 shall be available to a credit institution for unrestricted and immediate use to cover risks or losses as soon as these occur. The amount shall 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 62*

Member States may report to the Commission on the progress achieved in convergence with a view to a common definition of own funds. On the basis of these reports the Commission shall, if appropriate, by 1 January 2009, submit a proposal to the European Parliament and to the Council for amendment of this Section.

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### Article 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:

- 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; and
- 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.

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 competent authority;
- b the debt agreement shall 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 shall be wholly subordinated to those of all non-subordinated creditors;
- d the documents governing the issue of the securities shall provide for debt and unpaid interest to be such as to absorb losses, whilst leaving the credit institution in a position to continue trading; and
- e only fully paid-up amounts shall be taken into account.

To these securities and other instruments may be added cumulative preferential shares other than those referred to in point (h) of Article 57.

3 For credit institutions calculating risk-weighted exposure amounts under Section 3, Subsection 2, positive amounts resulting from the calculation in Annex VII, Part 1, point 36, may, up to 0,6 % of risk weighted exposure amounts calculated under Subsection 2, be accepted as other items. For these credit institutions value adjustments and provisions included in the calculation referred to in Annex VII, Part 1, point 36 and value adjustments and provisions for exposures referred to in point (e) of Article 57 shall not be included in own funds other than in accordance with this paragraph. For these purposes, risk-weighted exposure amounts shall not include those calculated in respect of securitisation positions which have a risk weight of 1 250 %.

### Article 64

1 The commitments of the members of credit institutions set up as cooperative societies referred to in point (g) of Article 57, 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 shall be possible to demand those payments without delay.

The joint and several commitments of borrowers in the case of credit institutions organised 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.

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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 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 shall fulfil the following additional criteria:

- a only fully paid-up funds may be taken into account;
- b the loans involved shall have an original maturity of at least five years, after which they may be repaid;
- c the extent to which they may rank as own funds shall be gradually reduced during at least the last five years before the repayment date; and
- d the loan agreement shall not include any clause providing that in specified circumstances, other than the winding-up of the credit institution, the debt shall become repayable before the agreed repayment date.

For the purposes of point (b) of the second subparagraph, if the maturity of the debt is not fixed, the loans involved 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.

4 Credit institutions shall not include in own funds either the fair value reserves related to gains or losses on cash flow hedges of financial instruments measured at amortised cost, or any gains or losses on their liabilities valued at fair value that are due to changes in the credit institutions' own credit standing.

#### *Article 65*

1 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:

- a any minority interests within the meaning of Article 21 of Directive 83/349/EEC, where the global integration method is used;
- b the first consolidation difference within the meaning of Articles 19, 30 and 31 of Directive 83/349/EEC;
- c the translation differences included in consolidated reserves in accordance with Article 39(6) of Directive 86/635/EEC; and
- d 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 items referred to in points (a) to (d) of paragraph 1 are debit ('positive') items, they shall be deducted in the calculation of consolidated own funds.

#### *Article 66*

1 The items referred to in points (d) to (h) of Article 57, shall be subject to the following limits:

- a the total of the items in points (d) to (h) may not exceed a maximum of 100 % of the items in points (a) plus (b) and (c) minus (i) to (k); and
- b the total of the items in points (g) to (h) may not exceed a maximum of 50 % of the items in points (a) plus (b) and (c) minus (i) to (k).

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2 The total of the items in points (l) to (r) of Article 57 shall be deducted half from the total of the items (a) to (c) minus (i) to (k), and half from the total of the items (d) to (h) of Article 57, after application of the limits laid down in paragraph 1 of this Article. To the extent that half of the total of the items (l) to (r) exceeds the total of the items (d) to (h) of Article 57, the excess shall be deducted from the total of the items (a) to (c) minus (i) to (k) of Article 57. Items in point (r) of Article 57 shall not be deducted if they have been included in the calculation of risk-weighted exposure amounts for the purposes of Article 75 as specified in Annex IX, Part 4.

3 For the purposes of Sections 5 and 6, the provisions laid down in this Section shall be read without taking into account the items referred to in points (q) and (r) of Article 57 and Article 63(3).

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

#### *Article 67*

Compliance with the conditions laid down in this Section shall be proved to the satisfaction of the competent authorities.

#### *Section 2*

#### ***Provision against risks***

#### *Subsection 1*

#### ***Level of application***

#### *Article 68*

1 Credit institutions shall comply with the obligations laid down in Articles 22 and 75 and Section 5 on an individual basis.

2 Every credit institution which is neither a subsidiary in the Member State where it is authorised and supervised, nor a parent undertaking, and every credit institution not included in the consolidation pursuant to Article 73, shall comply with the obligations laid down in Articles 120 and 123 on an individual basis.

3 Every credit institution which is neither a parent undertaking, nor a subsidiary, and every credit institution not included in the consolidation pursuant to Article 73, shall comply with the obligations laid down in Chapter 5 on an individual basis.

#### *Article 69*

1 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:

- a there is no current or foreseen material practical or legal impediment to the prompt transfer of own funds or repayment of liabilities by its parent undertaking;
- b either the parent undertaking satisfies the competent authority regarding the prudent management of the subsidiary and has declared, with the consent of the competent

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- authority, that it guarantees the commitments entered into by the subsidiary, or the risks in the subsidiary are of negligible interest;
- c the risk evaluation, measurement and control procedures of the parent undertaking cover the subsidiary; and
- d the parent undertaking holds more than 50 % of the voting rights attaching to shares in the capital of the subsidiary and/or has the right to appoint or remove a majority of the members of the management body of the subsidiary described in Article 11.

2 The Member States may exercise the option provided for in paragraph 1 where the parent undertaking is a financial holding company set up in the same Member State as the credit institution, provided that it is subject to the same supervision as that exercised over credit institutions, and in particular to the standards laid down in Article 71(1).

3 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:

- a there is no current or foreseen material practical or legal impediment to the prompt transfer of own funds or repayment of liabilities to the parent credit institution in a Member State; and
- b the risk evaluation, measurement and control procedures relevant for consolidated supervision cover the parent credit institution in a Member State.

The competent authority which makes use of this paragraph shall inform the competent authorities of all other Member States.

4 Without prejudice to the generality of Article 144, the competent authority of the Member States exercising the discretion laid down in paragraph 3 shall publicly disclose, in the manner indicated in Article 144:

- a criteria it applies to determine that there is no current or foreseen material practical or legal impediment to the prompt transfer of own funds or repayment of liabilities;
- b the number of parent credit institutions which benefit from the exercise of the discretion laid down in paragraph 3 and the number of these which incorporate subsidiaries in a third country; and
- c on an aggregate basis for the Member State:
  - (i) the total amount of own funds on the consolidated basis of the parent credit institution in a Member State, which benefits from the exercise of the discretion laid down in paragraph 3, which are held in subsidiaries in a third country;
  - (ii) the percentage of total own funds on the consolidated basis of parent credit institutions in a Member State which benefits from the exercise of the discretion laid down in paragraph 3, represented by own funds which are held in subsidiaries in a third country; and
  - (iii) the percentage of total minimum own funds required under Article 75 on the consolidated basis of parent credit institutions in a Member State, which benefits from the exercise of the discretion laid down in paragraph 3, represented by own funds which are held in subsidiaries in a third country.

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### Article 70

1 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.

2 The treatment in paragraph 1 shall be allowed only where the parent credit institution demonstrates fully to the competent authorities the circumstances and arrangements, including legal arrangements, by virtue of which there is no material practical or legal impediment, and none are foreseen, to the prompt transfer of own funds, or repayment of liabilities when due by the subsidiary to its parent undertaking.

3 Where a competent authority exercises the discretion laid down in paragraph 1, it shall on a regular basis and not less than once a year inform the competent authorities of all the other Member States of the use made of paragraph 1 and of the circumstances and arrangements referred to in paragraph 2. Where the subsidiary is in a third country, the competent authorities shall provide the same information to the competent authorities of that third country as well.

4 Without prejudice to the generality of Article 144, a competent authority which exercises the discretion laid down in paragraph 1 shall publicly disclose, in the manner indicated in Article 144:

- a the criteria it applies to determine that there is no current or foreseen material practical or legal impediment to the prompt transfer of own funds or repayment of liabilities;
- b the number of parent credit institutions which benefit from the exercise of the discretion laid down in paragraph 1 and the number of these which incorporate subsidiaries in a third country; and
- c on an aggregate basis for the Member State:
  - (i) the total amount of own funds of parent credit institutions which benefit from the exercise of the discretion laid down in paragraph 1 which are held in subsidiaries in a third country;
  - (ii) the percentage of total own funds of parent credit institutions which benefit from the exercise of the discretion laid down in paragraph 1 represented by own funds which are held in subsidiaries in a third country; and
  - (iii) the percentage of total minimum own funds required under Article 75 of parent credit institutions which benefit from the exercise of the discretion laid down in paragraph 1 represented by own funds which are held in subsidiaries in a third country.

### Article 71

1 Without prejudice to Articles 68 to 70, parent credit institutions in a Member State shall comply, to the extent and in the manner prescribed in Article 133, with the obligations laid down in Articles 75, 120, 123 and Section 5 on the basis of their consolidated financial situation.

2 Without prejudice to Articles 68 to 70, credit institutions controlled by a parent financial holding company in a Member State shall comply, to the extent and in the manner prescribed in Article 133, with the obligations laid down in Articles 75, 120, 123 and Section 5 on the basis of the consolidated financial situation of that financial holding company.

Where more than one credit institution is controlled by a parent financial holding company in a Member State, the first subparagraph shall apply only to the credit



institution to which supervision on a consolidated basis applies in accordance with Articles 125 and 126.

#### *Article 72*

1 EU parent credit institutions shall comply with the obligations laid down in Chapter 5 on the basis of their consolidated financial situation.

Significant subsidiaries of EU parent credit institutions shall disclose the information specified in Annex XII, Part 1, point 5, on an individual or sub-consolidated basis.

2 Credit institutions controlled by an EU parent financial holding company shall comply with the obligations laid down in Chapter 5 on the basis of the consolidated financial situation of that financial holding company.

Significant subsidiaries of EU parent financial holding companies shall disclose the information specified in Annex XII, Part 1, point 5, on an individual or sub-consolidated basis.

3 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.

#### *Article 73*

1 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:

- a where the undertaking concerned is situated in a third country where there are legal impediments to the transfer of the necessary information;
- b where, in the opinion of the competent authorities, the undertaking concerned is of negligible interest only with respect to the objectives of monitoring credit institutions and in any event where the balance-sheet total of the undertaking concerned is less than the smaller of the following two amounts:
  - (i) EUR 10 million, or
  - (ii) 1 % of the balance-sheet total of the parent undertaking or the undertaking that holds the participation,
- c where, in the opinion of the competent authorities responsible for exercising supervision on a consolidated basis, the consolidation of the financial situation of the undertaking concerned would be inappropriate or misleading as far as the objectives of the supervision of credit institutions are concerned.

If, in the cases referred to in point (b) of the first subparagraph, several undertakings meet the above criteria set out therein, they shall nevertheless be included in the consolidation where collectively they are of non-negligible interest with respect to the specified objectives.

2 Competent authorities shall require subsidiary credit institutions to apply the requirements laid down in Articles 75, 120 and 123 and Section 5 on a sub-consolidated basis if those credit institutions, or the parent undertaking where it is a financial holding company, have a credit institution or a financial institution or an asset management company as defined in

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Article 2(5) of Directive 2002/87/EC as a subsidiary in a third country, or hold a participation in such an undertaking.

3 Competent authorities shall require the parent undertakings and subsidiaries subject to this Directive to meet the obligations laid down in Article 22 on a consolidated or sub# consolidated basis, to ensure that their arrangements, processes and mechanisms are consistent and well-integrated and that any data and information relevant to the purpose of supervision can be produced.

### *Subsection 2*

#### ***Calculation of requirements***

##### *Article 74*

1 Save where otherwise provided, the valuation of assets and off-balance-sheet items shall be effected in accordance with the accounting framework to which the credit institution is subject under Regulation (EC) No 1606/2002 and Directive 86/635/EEC.

2 Notwithstanding the requirements laid down in Articles 68 to 72, the calculations to verify the compliance of credit institutions with the obligations laid down in Article 75 shall be carried out not less than twice each year.

The credit institutions shall communicate the results and any component data required to the competent authorities.

### *Subsection 3*

#### ***Minimum level of own funds***

##### *Article 75*

Without prejudice to Article 136, Member States shall require credit institutions to provide own funds which are at all times more than or equal to the sum of the following capital requirements:

- (a) for credit risk and dilution risk in respect of all of their business activities with the exception of their trading book business and illiquid assets if deducted from own funds under Article 13(2)(d) of Directive 2006/49/EC, 8 % of the total of their risk-weighted exposure amounts calculated in accordance with Section 3;
- (b) in respect of their trading-book business, for position risk, settlement and counter# party risk and, in so far as the limits laid down in Articles 111 to 117 are authorised to be exceeded, for large exposures exceeding such limits, the capital requirements determined in accordance with Article 18 and Chapter V, Section 4 of Directive 2006/49/EC;
- (c) in respect of all of their business activities, for foreign-exchange risk and for commodities risk, the capital requirements determined according to Article 18 of Directive 2006/49/EC; and
- (d) in respect of all of their business activities, for operational risk, the capital requirements determined in accordance with Section 4.

### *Section 3*

#### ***Minimum own funds requirements for credit risk***

##### *Article 76*

Credit institutions shall apply either the Standardised Approach provided for in Articles 78 to 83 or, if permitted by the competent authorities in accordance with Article 84, the Internal Ratings Based Approach provided for in Articles 84 to 89 to calculate their risk-weighted exposure amounts for the purposes of Article 75(a).

##### *Article 77*

‘Exposure’ for the purposes of this Section means an asset or off-balance sheet item.

##### *Subsection 1*

#### ***Standardised approach***

##### *Article 78*

1 Subject to paragraph 2, the exposure value of an asset item shall be its balance-sheet value and the exposure value of an off-balance sheet item listed in Annex II shall be the following percentage of its value: 100 % if it is a full-risk item, 50 % if it is a medium-risk item, 20 % if it is a medium/low-risk item, 0 % if it is a low-risk item. The off-balance sheet items referred to in the first sentence of this paragraph shall be assigned to risk categories as indicated in Annex II. In the case of a credit institution using the Financial Collateral Comprehensive Method under Annex VIII, Part 3, where an exposure takes the form of securities or commodities sold, posted or lent under a repurchase transaction or under a securities or commodities lending or borrowing transaction, and margin lending transactions the exposure value shall be increased by the volatility adjustment appropriate to such securities or commodities as prescribed in Annex VIII, Part 3, points 34 to 59.

2 The exposure value of a derivative instrument listed in Annex IV shall be determined in accordance with Annex III with the effects of contracts of novation and other netting agreements taken into account for the purposes of those methods in accordance with Annex III. The exposure value of repurchase transactions, securities or commodities lending or borrowing transactions, long settlement transactions and margin lending transactions may be determined either in accordance with Annex III or Annex VIII.

3 Where an exposure is subject to funded credit protection, the exposure value applicable to that item may be modified in accordance with Subsection 3.

4 Notwithstanding paragraph 2, the exposure value of credit risk exposures outstanding, as determined by the competent authorities, with a central counterparty shall be determined in accordance with Annex III, Part 2, point 6, provided that the central counterparty's counterparty credit risk exposures with all participants in its arrangements are fully collateralised on a daily basis.

##### *Article 79*

1 Each exposure shall be assigned to one of the following exposure classes:

- a claims or contingent claims on central governments or central banks;
- b claims or contingent claims on regional governments or local authorities;

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- c claims or contingent claims on administrative bodies and non-commercial undertakings;
  - d claims or contingent claims on multilateral development banks;
  - e claims or contingent claims on international organisations;
  - f claims or contingent claims on institutions;
  - g claims or contingent claims on corporates;
  - h retail claims or contingent retail claims;
  - i claims or contingent claims secured on real estate property;
  - j past due items;
  - k items belonging to regulatory high-risk categories;
  - l claims in the form of covered bonds;
  - m securitisation positions;
  - n short-term claims on institutions and corporate;
  - o claims in the form of collective investment undertakings ('CIU'); or
  - p other items.
- 2 To be eligible for the retail exposure class referred to in point (h) of paragraph 1, an exposure shall meet the following conditions:
- a the exposure shall be either to an individual person or persons, or to a small or medium sized entity;
  - b the exposure shall be one of a significant number of exposures with similar characteristics such that the risks associated with such lending are substantially reduced; and
  - c the total amount owed to the credit institution and parent undertakings and its subsidiaries, including any past due exposure, by the obligor client or group of connected clients, but excluding claims or contingent claims secured on residential real estate collateral, shall not, to the knowledge of the credit institution, exceed EUR 1 million. The credit institution shall take reasonable steps to acquire this knowledge.

Securities shall not be eligible for the retail exposure class.

- 3 The present value of retail minimum lease payments is eligible for the retail exposure class.

#### *Article 80*

1 To calculate risk-weighted exposure amounts, risk weights shall be applied to all exposures, unless deducted from own funds, in accordance with the provisions of Annex VI, Part 1. The application of risk weights shall be based on the exposure class to which the exposure is assigned and, to the extent specified in Annex VI, Part 1, its credit quality. Credit quality may be determined by reference to the credit assessments of External Credit Assessment Institutions ('ECAIs') in accordance with the provisions of Articles 81 to 83 or the credit assessments of Export Credit Agencies as described in Annex VI, Part 1.

2 For the purposes of applying a risk weight, as referred to in paragraph 1, the exposure value shall be multiplied by the risk weight specified or determined in accordance with this Subsection.

3 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.

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4 Notwithstanding paragraph 1, where an exposure is subject to credit protection the risk weight applicable to that item may be modified in accordance with Subsection 3.

5 Risk-weighted exposure amounts for securitised exposures shall be calculated in accordance with Subsection 4.

6 Exposures the calculation of risk-weighted exposure amounts for which is not otherwise provided for under this Subsection shall be assigned a risk-weight of 100 %.

7 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:

- a the counterparty is an institution or a financial holding company, financial institution, asset management company or ancillary services undertaking subject to appropriate prudential requirements;
- b the counterparty is included in the same consolidation as the credit institution on a full basis;
- c the counterparty is subject to the same risk evaluation, measurement and control procedures as the credit institution;
- d the counterparty is established in the same Member State as the credit institution; and
- e there is no current or foreseen material practical or legal impediment to the prompt transfer of own funds or repayment of liabilities from the counterparty to the credit institution.

In such a case, a risk weight of 0 % shall be assigned.

8 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:

- a the requirements set out in points (a), (d) and (e) of paragraph 7;
- b the credit institution and the counterparty have entered into a contractual or statutory liability arrangement which protects those institutions and in particular ensures their liquidity and solvency to avoid bankruptcy in case it becomes necessary (referred to below as an institutional protection scheme);
- c the arrangements ensure that the institutional protection scheme will be able to grant support necessary under its commitment from funds readily available to it;
- d the institutional protection scheme disposes of suitable and uniformly stipulated systems for the monitoring and classification of risk (which gives a complete overview of the risk situations of all the individual members and the institutional protection scheme as a whole) with corresponding possibilities to take influence; those systems shall suitably monitor defaulted exposures in accordance with Annex VII, Part 4, point 44;
- e the institutional protection scheme conducts its own risk review which is communicated to the individual members;
- f the institutional protection scheme draws up and publishes once in a year either, a consolidated report comprising the balance sheet, the profit-and-loss account, the situation report and the risk report, concerning the institutional protection scheme as a whole, or a report comprising the aggregated balance sheet, the aggregated profit#

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- and loss account, the situation report and the risk report, concerning the institutional protection scheme as a whole;
- g members of the institutional protection scheme are obliged to give advance notice of at least 24 months if they wish to end the arrangements;
  - h the multiple use of elements eligible for the calculation of own funds ('multiple gearing') as well as any inappropriate creation of own funds between the members of the institutional protection scheme shall be eliminated;
  - i the institutional protection scheme shall be based on a broad membership of credit institutions of a predominantly homogeneous business profile; and
  - j the adequacy of the systems referred to in point (d) is approved and monitored at regular intervals by the relevant competent authorities.

In such a case, a risk weight of 0 % shall be assigned.

#### *Article 81*

1 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).

2 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.

3 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.

4 Competent authorities shall make publicly available an explanation of the recognition process, and a list of eligible ECAIs.

#### *Article 82*

1 The competent authorities shall determine, taking into account the technical criteria set out in Annex VI, Part 2, with which of the credit quality steps set out in Part 1 of that Annex the relevant credit assessments of an eligible ECAI are to be associated. Those determinations shall be objective and consistent.

2 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.

#### *Article 83*

1 The use of ECAI credit assessments for the calculation of a credit institution's risk-weighted exposure amounts shall be consistent and in accordance with Annex VI, Part 3. Credit assessments shall not be used selectively.

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

## *Subsection 2*

### ***Internal Ratings Based Approach***

#### *Article 84*

1 In accordance with this Subsection, the competent authorities may permit credit institutions to calculate their risk-weighted exposure amounts using the Internal Ratings Based Approach ('IRB Approach'). Explicit permission shall be required in the case of each credit institution.

2 Permission shall be given only if the competent authority is satisfied that the credit institution's systems for the management and rating of credit risk exposures are sound and implemented with integrity and, in particular, that they meet the following standards in accordance with Annex VII, Part 4:

- a the credit institution's rating systems provide for a meaningful assessment of obligor and transaction characteristics, a meaningful differentiation of risk and accurate and consistent quantitative estimates of risk;
- b internal ratings and default and loss estimates used in the calculation of capital requirements and associated systems and processes play an essential role in the risk management and decision-making process, and in the credit approval, internal capital allocation and corporate governance functions of the credit institution;
- c the credit institution has a credit risk control unit responsible for its rating systems that is appropriately independent and free from undue influence;
- d the credit institution collects and stores all relevant data to provide effective support to its credit risk measurement and management process; and
- e the credit institution documents its rating systems and the rationale for their design and validates its rating systems.

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.

3 A credit institution applying for the use of the IRB Approach shall demonstrate that it has been using for the IRB exposure classes in question rating systems that were broadly in line with the minimum requirements set out in Annex VII, Part 4 for internal risk measurement and management purposes for at least three years prior to its qualification to use the IRB Approach.

4 A credit institution applying for the use of own estimates of LGDs and/or conversion factors shall demonstrate that it has been estimating and employing own estimates of LGDs and/or conversion factors in a manner that was broadly consistent with the minimum requirements for use of own estimates of those parameters set out in Annex VII, Part 4 for at least three years prior to qualification to use own estimates of LGDs and/or conversion factors.

5 If a credit institution ceases to comply with the requirements set out in this Subsection, it shall either present to the competent authority a plan for a timely return to compliance or demonstrate that the effect of non-compliance is immaterial.

6 When the IRB Approach is intended to be used by the EU parent credit institution and its subsidiaries, or by the EU parent financial holding company and its subsidiaries, the competent authorities of the different legal entities shall cooperate closely as provided for in Articles 129 to 132.

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### Article 85

1 Without prejudice to Article 89, credit institutions and any parent undertaking and its subsidiaries shall implement the IRB Approach for all exposures.

Subject to the approval of the competent authorities, implementation may be carried out sequentially across the different exposure classes, referred to in Article 86, within the same business unit, across different business units in the same group or for the use of own estimates of LGDs or conversion factors for the calculation of risk weights for exposures to corporates, institutions, and central governments and central banks.

In the case of the retail exposure class referred to in Article 86, implementation may be carried out sequentially across the categories of exposures to which the different correlations in Annex VII, Part 1, points 10 to 13 correspond.

2 Implementation as referred to in paragraph 1 shall be carried out within a reasonable period of time to be agreed with the competent authorities. The implementation shall be carried out subject to strict conditions determined by the competent authorities. Those conditions shall be designed to ensure that the flexibility under paragraph 1 is not used selectively with the purpose of achieving reduced minimum capital requirements in respect of those exposure classes or business units that are yet to be included in the IRB Approach or in the use of own estimates of LGDs and/or conversion factors.

3 Credit institutions using the IRB Approach for any exposure class shall at the same time use the IRB Approach for the equity exposure class.

4 Subject to paragraphs 1 to 3 of this Article and Article 89, credit institutions which have obtained permission under Article 84 to use the IRB Approach shall not revert to the use of Subsection 1 for the calculation of risk-weighted exposure amounts except for demonstrated good cause and subject to the approval of the competent authorities.

5 Subject to paragraphs 1 and 2 of this Article and Article 89, credit institutions which have obtained permission under Article 87(9) to use own estimates of LGDs and conversion factors, shall not revert to the use of LGD values and conversion factors referred to in Article 87(8) except for demonstrated good cause and subject to the approval of the competent authorities.

### Article 86

1 Each exposure shall be assigned to one of the following exposure classes:

- a claims or contingent claims on central governments and central banks;
- b claims or contingent claims on institutions;
- c claims or contingent claims on corporates;
- d retail claims or contingent retail claims;
- e equity claims;
- f securitisation positions; or
- g other non credit-obligation assets.

2 The following exposures shall be treated as exposures to central governments and central banks:

- a exposures to regional governments, local authorities or public sector entities which are treated as exposures to central governments under Subsection 1; and
- b exposures to Multilateral Development Banks and International Organisations which attract a risk weight of 0 % under Subsection 1.



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- 3 The following exposures shall be treated as exposures to institutions:
- a exposures to regional governments and local authorities which are not treated as exposures to central governments under Subsection 1;
  - b exposures to Public Sector Entities which are treated as exposures to institutions under the Subsection 1; and
  - c exposures to Multilateral Development Banks which do not attract a 0 % risk weight under Subsection 1.

4 To be eligible for the retail exposure class referred to in point (d) of paragraph 1, exposures shall meet the following criteria:

- a they shall be either to an individual person or persons, or to a small or medium sized entity, provided in the latter case that the total amount owed to the credit institution and parent undertakings and its subsidiaries, including any past due exposure, by the obligor client or group of connected clients, but excluding claims or contingent claims secured on residential real estate collateral, shall not, to the knowledge of the credit institution, which shall have taken reasonable steps to confirm the situation, exceed EUR 1 million;
- b they are treated by the credit institution in its risk management consistently over time and in a similar manner;
- c they are not managed just as individually as exposures in the corporate exposure class; and
- d they each represent one of a significant number of similarly managed exposures.

The present value of retail minimum lease payments is eligible for the retail exposure class.

- 5 The following exposures shall be classed as equity exposures:
- a non-debt exposures conveying a subordinated, residual claim on the assets or income of the issuer; and
  - b debt exposures the economic substance of which is similar to the exposures specified in point (a).

6 Within the corporate exposure class, credit institutions shall separately identify as specialised lending exposures, exposures which possess the following characteristics:

- a the exposure is to an entity which was created specifically to finance and/or operate physical assets;
- b the contractual arrangements give the lender a substantial degree of control over the assets and the income that they generate; and
- c the primary source of repayment of the obligation is the income generated by the assets being financed, rather than the independent capacity of a broader commercial enterprise.

7 Any credit obligation not assigned to the exposure classes referred to in points (a), (b) and (d) to (f) of paragraph 1 shall be assigned to the exposure class referred to in point (c) of that paragraph.

8 The exposure class referred to in point (g) of paragraph 1 shall include the residual value of leased properties if not included in the lease exposure as defined in Annex VII, Part 3, paragraph 4.

9 The methodology used by the credit institution for assigning exposures to different exposure classes shall be appropriate and consistent over time.

### Article 87

1 The risk-weighted exposure amounts for credit risk for exposures belonging to one of the exposure classes referred to in points (a) to (e) or (g) of Article 86(1) shall, unless deducted from own funds, be calculated in accordance with Annex VII, Part 1, points 1 to 27.

2 The risk-weighted exposure amounts for dilution risk for purchased receivables shall be calculated according to Annex VII, Part 1, point 28. Where a credit institution has full recourse in respect of purchased receivables for default risk and for dilution risk, to the seller of the purchased receivables, the provisions of Articles 87 and 88 in relation to purchased receivables need not be applied. The exposure may instead be treated as a collateralised exposure.

3 The calculation of risk-weighted exposure amounts for credit risk and dilution risk shall be based on the relevant parameters associated with the exposure in question. These shall include probability of default (PD), LGD, maturity (M) and exposure value of the exposure. PD and LGD may be considered separately or jointly, in accordance with Annex VII, Part 2.

4 Notwithstanding paragraph 3, the calculation of risk-weighted exposure amounts for credit risk for all exposures belonging to the exposure class referred to in point (e) of Article 86(1) shall be calculated in accordance with Annex VII, Part 1, points 17 to 26 subject to approval of the competent authorities. Competent authorities shall only allow a credit institution to use the approach set out in Annex VII, Part 1, points 25 and 26 if the credit institution meets the minimum requirements set out in Annex VII, Part 4, points 115 to 123.

5 Notwithstanding paragraph 3, the calculation of risk weighted exposure amounts for credit risk for specialised lending exposures may be calculated in accordance with Annex VII, Part 1, point 6. Competent authorities shall publish guidance on how credit institutions should assign risk weights to specialised lending exposures under Annex VII, Part 1, point 6 and shall approve credit institution assignment methodologies.

6 For exposures belonging to the exposure classes referred to in points (a) to (d) of Article 86(1), credit institutions shall provide their own estimates of PDs in accordance with Article 84 and Annex VII, Part 4.

7 For exposures belonging to the exposure class referred to in point (d) of Article 86(1), credit institutions shall provide own estimates of LGDs and conversion factors in accordance with Article 84 and Annex VII, Part 4.

8 For exposures belonging to the exposure classes referred to in points (a) to (c) of Article 86(1), credit institutions shall apply the LGD values set out in Annex VII, Part 2, point 8, and the conversion factors set out in Annex VII, Part 3, point 9(a) to (d).

9 Notwithstanding paragraph 8, for all exposures belonging to the exposure classes referred to in points (a) to (c) of Article 86(1), competent authorities may permit credit institutions to use own estimates of LGDs and conversion factors in accordance with Article 84 and Annex VII, Part 4.

10 The risk-weighted exposure amounts for securitised exposures and for exposures belonging to the exposure class referred to in point (f) of Article 86(1) shall be calculated in accordance with Subsection 4.

11 Where exposures in the form of a collective investment undertaking (CIU) meet the criteria set out in Annex VI, Part 1, points 77 and 78 and the credit institution is aware of all of the underlying exposures of the CIU, the credit institution shall look through to those underlying

exposures in order to calculate risk-weighted exposure amounts and expected loss amounts in accordance with the methods set out in this Subsection.

Where the credit institution does not meet the conditions for using the methods set out in this Subsection, risk weighted exposure amounts and expected loss amounts shall be calculated in accordance with the following approaches:

- a for exposures belonging to the exposure class referred to in point (e) of Article 86(1), the approach set out in Annex VII, Part 1, points 19 to 21. If, for those purposes, the credit institution is unable to differentiate between private equity, exchange-traded and other equity exposures, it shall treat the exposures concerned as other equity exposures;
- b for all other underlying exposures, the approach set out in Subsection 1, subject to the following modifications:
  - (i) the exposures are assigned to the appropriate exposure class and attributed the risk weight of the credit quality step immediately above the credit quality step that would normally be assigned to the exposure, and
  - (ii) exposures assigned to the higher credit quality steps, to which a risk weight of 150 % would normally be attributed, are assigned a risk weight of 200 %.

12 Where exposures in the form of a CIU do not meet the criteria set out in Annex VI, Part 1, points 77 and 78, or the credit institution is not aware of all of the underlying exposures of the CIU, the credit institution shall look through to the underlying exposures and calculate risk-weighted exposure amounts and expected loss amounts in accordance with the approach set out in Annex VII, Part 1, points 19 to 21. If, for those purposes, the credit institution is unable to differentiate between private equity, exchange-traded and other equity exposures, it shall treat the exposures concerned as other equity exposures. For these purposes, non equity exposures are assigned to one of the classes (private equity, exchange traded equity or other equity) set out in Annex VII, Part 1, point 19 and unknown exposures are assigned to other equity class.

Alternatively to the method described above, credit institutions may calculate themselves or may rely on a third party to calculate and report the average risk weighted exposure amounts based on the CIU's underlying exposures in accordance with the following approaches, provided that the correctness of the calculation and the report is adequately ensured:

- a for exposures belonging to the exposure class referred to in point (e) of Article 86(1), the approach set out in Annex VII, Part 1, points 19 to 21. If, for those purposes, the credit institution is unable to differentiate between private equity, exchange-traded and other equity exposures, it shall treat the exposures concerned as other equity exposures; or
- b for all other underlying exposures, the approach set out in Subsection 1, subject to the following modifications:
  - (i) the exposures are assigned to the appropriate exposure class and attributed the risk weight of the credit quality step immediately above the credit quality step that would normally be assigned to the exposure, and
  - (ii) exposures assigned to the higher credit quality steps, to which a risk weight of 150 % would normally be attributed, are assigned a risk weight of 200 %.

#### *Article 88*

1 The expected loss amounts for exposures belonging to one of the exposure classes referred to in points (a) to (e) of Article 86(1) shall be calculated in accordance with the methods set out in Annex VII, Part 1, points 29 to 35.

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2 The calculation of expected loss amounts in accordance with Annex VII, Part 1, points 29 to 35 shall be based on the same input figures of PD, LGD and the exposure value for each exposure as being used for the calculation of risk-weighted exposure amounts in accordance with Article 87. For defaulted exposures, where credit institutions use own estimates of LGDs, expected loss ('EL') shall be the credit institution's best estimate of EL ('EL<sub>BE</sub>') for the defaulted exposure, in accordance with Annex VII, Part 4, point 80.

3 The expected loss amounts for securitised exposures shall be calculated in accordance with Subsection 4.

4 The expected loss amount for exposures belonging to the exposure class referred to in point (g) of Article 86(1) shall be zero.

5 The expected loss amounts for dilution risk of purchased receivables shall be calculated in accordance with the methods set out in Annex VII, Part 1, point 35.

6 The expected loss amounts for exposures referred to in Article 87(11) and (12) shall be calculated in accordance with the methods set out in Annex VII, Part 1, points 29 to 35.

#### *Article 89*

1 Subject to the approval of the competent authorities, credit institutions permitted to use the IRB Approach in the calculation of risk-weighted exposure amounts and expected loss amounts for one or more exposure classes may apply Subsection 1 for the following:

- a the exposure class referred to in point (a) of Article 86(1), where the number of material counterparties is limited and it would be unduly burdensome for the credit institution to implement a rating system for these counterparties;
- b the exposure class referred to in point (b) of Article 86(1), where the number of material counterparties is limited and it would be unduly burdensome for the credit institution to implement a rating system for these counterparties;
- c exposures in non-significant business units as well as exposure classes that are immaterial in terms of size and perceived risk profile;
- d exposures to central governments of the home Member State and to their regional governments, local authorities and administrative bodies, provided that:
  - (i) there is no difference in risk between the exposures to that central government and those other exposures because of specific public arrangements, and
  - (ii) exposures to the central government are assigned a 0 % risk weight under Subsection 1;
- e exposures of a credit institution to a counterparty which is its parent undertaking, its subsidiary or a subsidiary of its parent undertaking provided that the counterparty is an institution or a financial holding company, financial institution, asset management company or ancillary services undertaking subject to appropriate prudential requirements or an undertaking linked by a relationship within the meaning of Article 12(1) of Directive 83/349/EEC and exposures between credit institutions which meet the requirements set out in Article 80(8);
- f equity exposures to entities whose credit obligations qualify for a 0 % risk weight under Subsection 1 (including those publicly sponsored entities where a zero risk weight can be applied);
- g equity exposures incurred under legislative programmes to promote specified sectors of the economy that provide significant subsidies for the investment to the credit institution and involve some form of government oversight and restrictions on the equity

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- investments. This exclusion is limited to an aggregate of 10 % of original own funds plus additional own funds;
- h the exposures identified in Annex VI, Part 1, point 40 meeting the conditions specified therein; or
  - i State and State-reinsured guarantees pursuant to Annex VIII, Part 2, point 19.

This paragraph shall not prevent the competent authorities of other Member States to allow the application of the rules of Subsection 1 for equity exposures which have been allowed for this treatment in other Member States.

2 For the purposes of paragraph 1, the equity exposure class of a credit institution shall be considered material if their aggregate value, excluding equity exposures incurred under legislative programmes as referred to in paragraph 1, point (g), exceeds, on average over the preceding year, 10 % of the credit institution's own funds. If the number of those equity exposures is less than 10 individual holdings, that threshold shall be 5 % of the credit institution's own funds.

### *Subsection 3*

#### ***Credit risk mitigation***

##### *Article 90*

For the purposes of this Subsection, 'lending credit institution' shall mean the credit institution which has the exposure in question, whether or not deriving from a loan.

##### *Article 91*

Credit institutions using the Standardised Approach under Articles 78 to 83 or using the IRB Approach under Articles 84 to 89, but not using their own estimates of LGD and conversion factors under Articles 87 and 88, may recognise credit risk mitigation in accordance with this Subsection in the calculation of risk-weighted exposure amounts for the purposes of Article 75 point (a) or as relevant expected loss amounts for the purposes of the calculation referred to in point (q) of Article 57, and Article 63(3).

##### *Article 92*

1 The technique used to provide the credit protection together with the actions and steps taken and procedures and policies implemented by the lending credit institution shall be such as to result in credit protection arrangements which are legally effective and enforceable in all relevant jurisdictions.

2 The lending credit institution shall take all appropriate steps to ensure the effectiveness of the credit protection arrangement and to address related risks.

3 In the case of funded credit protection, to be eligible for recognition the assets relied upon shall be sufficiently liquid and their value over time sufficiently stable to provide appropriate certainty as to the credit protection achieved having regard to the approach used to calculate risk-weighted exposure amounts and to the degree of recognition allowed. Eligibility shall be limited to the assets set out in Annex VIII, Part 1.

4 In the case of funded credit protection, the lending credit institution shall have the right to liquidate or retain, in a timely manner, the assets from which the protection derives in the event of the default, insolvency or bankruptcy of the obligor — or other credit event set out in the transaction documentation — and, where applicable, of the custodian holding the

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collateral. The degree of correlation between the value of the assets relied upon for protection and the credit quality of the obligor shall not be undue.

5 In the case of unfunded credit protection, to be eligible for recognition the party giving the undertaking shall be sufficiently reliable, and the protection agreement legally effective and enforceable in the relevant jurisdictions, to provide appropriate certainty as to the credit protection achieved having regard to the approach used to calculate risk-weighted exposure amounts and to the degree of recognition allowed. Eligibility shall be limited to the protection providers and types of protection agreement set out in Annex VIII, Part 1.

6 The minimum requirements set out in Annex VIII, Part 2 shall be complied with.

#### *Article 93*

1 Where the requirements of Article 92 are met the calculation of risk-weighted exposure amounts, and, as relevant, expected loss amounts, may be modified in accordance with Annex VIII, Parts 3 to 6.

2 No exposure in respect of which credit risk mitigation is obtained shall produce a higher risk-weighted exposure amount or expected loss amount than an otherwise identical exposure in respect of which there is no credit risk mitigation.

3 Where the risk-weighted exposure amount already takes account of credit protection under Articles 78 to 83 or Articles 84 to 89, as relevant, the calculation of the credit protection shall not be further recognised under this Subsection.

#### *Subsection 4*

### ***Securitisation***

#### *Article 94*

Where a credit institution uses the Standardised Approach set out in Articles 78 to 83 for the calculation of risk-weighted exposure amounts for the exposure class to which the securitised exposures would be assigned under Article 79, it shall calculate the risk-weighted exposure amount for a securitisation position in accordance with Annex IX, Part 4, points 1 to 36.

In all other cases, it shall calculate the risk-weighted exposure amount in accordance with Annex IX, Part 4, points 1 to 5 and 37 to 76.

#### *Article 95*

1 Where significant credit risk associated with securitised exposures has been transferred from the originator credit institution in accordance with the terms of Annex IX, Part 2, that credit institution may:

- a in the case of a traditional securitisation, exclude from its calculation of risk-weighted exposure amounts, and, as relevant, expected loss amounts, the exposures which it has securitised; and
- b in the case of a synthetic securitisation, calculate risk-weighted exposure amounts, and, as relevant, expected loss amounts, in respect of the securitised exposures in accordance with Annex IX, Part 2.

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2 Where paragraph 1 applies, the originator credit institution shall calculate the risk-weighted exposure amounts prescribed in Annex IX for the positions that it may hold in the securitisation.

Where the originator credit institution fails to transfer significant credit risk in accordance with paragraph 1, it need not calculate risk-weighted exposure amounts for any positions it may have in the securitisation in question.

#### *Article 96*

1 To calculate the risk-weighted exposure amount of a securitisation position, risk weights shall be assigned to the exposure value of the position in accordance with Annex IX, based on the credit quality of the position, which may be determined by reference to an ECAI credit assessment or otherwise, as set out in Annex IX.

2 Where there is an exposure to different tranches in a securitisation, the exposure to each tranche shall be considered a separate securitisation position. The providers of credit protection to securitisation positions shall be considered to hold positions in the securitisation. Securitisation positions shall include exposures to a securitisation arising from interest rate or currency derivative contracts.

3 Where a securitisation position is subject to funded or unfunded credit protection the risk-weight to be applied to that position may be modified in accordance with Articles 90 to 93, read in conjunction with Annex IX.

4 Subject to point (r) of Article 57 and Article 66(2), the risk-weighted exposure amount shall be included in the credit institution's total of risk-weighted exposure amounts for the purposes of Article 75(a).

#### *Article 97*

1 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').

2 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.

3 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.

4 The competent authorities shall make publicly available an explanation of the recognition process and a list of eligible ECAs.

5 To be used for the purposes of paragraph 1, a credit assessment of an eligible ECAI shall comply with the principles of credibility and transparency as elaborated in Annex IX, Part 3.

#### *Article 98*

1 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

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credit assessments of an eligible ECAI are to be associated. Those determinations shall be objective and consistent.

2 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.

#### *Article 99*

The use of ECAI credit assessments for the calculation of a credit institution's risk-weighted exposure amounts under Article 96 shall be consistent and in accordance with Annex IX, Part 3. Credit assessments shall not be used selectively.

#### *Article 100*

1 Where there is a securitisation of revolving exposures subject to an early amortisation provision, the originator credit institution shall calculate, in accordance with Annex IX, an additional risk-weighted exposure amount in respect of the risk that the levels of credit risk to which it is exposed may increase following the operation of the early amortisation provision.

2 For those purposes, a 'revolving exposure' shall be an exposure whereby customers' outstanding balances are permitted to fluctuate based on their decisions to borrow and repay, up to an agreed limit, and an early amortisation provision shall be a contractual clause which requires, on the occurrence of defined events, investors' positions to be redeemed before the originally stated maturity of the securities issued.

#### *Article 101*

1 An originator credit institution which, in respect of a securitisation, has made use of Article 95 in the calculation of risk-weighted exposure amounts or a sponsor credit institution shall not, with a view to reducing potential or actual losses to investors, provide support to the securitisation beyond its contractual obligations.

2 If an originator credit institution or a sponsor credit institution fails to comply with paragraph 1 in respect of a securitisation, the competent authority shall require it at a minimum, to hold capital against all of the securitised exposures as if they had not been securitised. The credit institution shall disclose publicly that it has provided non#contractual support and the regulatory capital impact of having done so.

### *Section 4*

#### ***Minimum own funds requirements for operational risk***

#### *Article 102*

1 Competent authorities shall require credit institutions to hold own funds against operational risk in accordance with the approaches set out in Articles 103, 104 and 105.

2 Without prejudice to paragraph 4, credit institutions that use the approach set out in Article 104 shall not revert to the use of the approach set out in Article 103, except for demonstrated good cause and subject to approval by the competent authorities.

3 Without prejudice to paragraph 4, credit institutions that use the approach set out in Article 105 shall not revert to the use of the approaches set out in Articles 103 or 104 except for demonstrated good cause and subject to approval by the competent authorities.



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

#### *Article 103*

The capital requirement for operational risk under the Basic Indicator Approach shall be a certain percentage of a relevant indicator, in accordance with the parameters set out in Annex X, Part 1.

#### *Article 104*

1 Under the Standardised Approach, credit institutions shall divide their activities into a number of business lines as set out in Annex X, Part 2.

2 For each business line, credit institutions shall calculate a capital requirement for operational risk as a certain percentage of a relevant indicator, in accordance with the parameters set out in Annex X, Part 2.

3 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.

4 The capital requirement for operational risk under the Standardised Approach shall be the sum of the capital requirements for operational risk across all individual business lines.

5 The parameters for the Standardised Approach are set out in Annex X, Part 2.

6 To qualify for use of the Standardised Approach, credit institutions shall meet the criteria set out in Annex X, Part 2.

#### *Article 105*

1 Credit institutions may use Advanced Measurement Approaches based on their own operational risk measurement systems, provided that the competent authority expressly approves the use of the models concerned for calculating the own funds requirement.

2 Credit institutions shall satisfy their competent authorities that they meet the qualifying criteria set out in Annex X, Part 3.

3 When an Advanced Measurement Approach is intended to be used by an EU parent credit institution and its subsidiaries or by the subsidiaries of an EU parent financial holding company, the competent authorities of the different legal entities shall cooperate closely as provided for in Articles 129 to 132. The application shall include the elements listed in Annex X, Part 3.

4 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.

## Section 5

### **Large exposures**

#### *Article 106*

1 'Exposures', for the purposes of this Section, shall mean any asset or off#balance# sheet item referred to in Section 3, Subsection 1, without application of the risk weights or degrees of risk there provided for.

Exposures arising from the items referred to in Annex IV shall be calculated in accordance with one of the methods set out in Annex III. For the purposes of this Section, Annex III, Part 2, point 2 shall also apply.

All elements entirely covered by own funds may, with the agreement of the competent authorities, be excluded from the determination of exposures, provided that such own funds are not included in the credit institution's own funds for the purposes of Article 75 or in the calculation of other monitoring ratios provided for in this Directive and in other Community acts.

- 2 Exposures shall not include either of the following:
- a in the case of foreign exchange transactions, exposures incurred in the ordinary course of settlement during the 48 hours following payment; or
  - b in the case of transactions for the purchase or sale of securities, exposures incurred in the ordinary course of settlement during the five working days following payment or delivery of the securities, whichever is the earlier.

#### *Article 107*

For the purposes of applying this Section, the term 'credit institution' shall cover the following:

- (a) a credit institution, including its branches in third countries; and
- (b) any private or public undertaking, including its branches, which meets the definition of 'credit institution' and has been authorised in a third country.

#### *Article 108*

A credit institution's exposure to a client or group of connected clients shall be considered a large exposure where its value is equal to or exceeds 10 % of its own funds.

#### *Article 109*

The competent authorities shall require that every credit institution have sound administrative and accounting procedures and adequate internal control mechanisms for the purposes of identifying and recording all large exposures and subsequent changes to them, in accordance with this Directive, and for that of monitoring those exposures in the light of each credit institution's own exposure policies.

#### *Article 110*

- 1 A credit institution shall report every large exposure to the competent authorities. Member States shall provide that reporting is to be carried out, at their discretion, in accordance with one of the following two methods:

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- a reporting of all large exposures at least once a year, combined with reporting during the year of all new large exposures and any increases in existing large exposures of at least 20 % with respect to the previous communication; or
- b reporting of all large exposures at least four times a year.

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

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

3 Member States 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.

#### *Article 111*

1 A credit institution may not incur an exposure to a client or group of connected clients the value of which exceed 25 % of its own funds.

2 Where that client or group of connected clients is the parent undertaking or subsidiary of the credit institution and/or one or more subsidiaries of that parent undertaking, the percentage laid down in paragraph 1 shall be reduced to 20 %. Member States may, however, exempt the exposures incurred to such clients from the 20 % limit if they provide for specific monitoring of such exposures by other measures or procedures. They shall inform the Commission and the European Banking Committee of the content of such measures or procedures.

3 A credit institution may not incur large exposures which in total exceed 800 % of its own funds.

4 A credit institution shall at all times comply with the limits laid down in paragraphs 1, 2 and 3 in respect of its exposures. If in an exceptional case exposures exceed those limits, that fact shall be reported without delay to the competent authorities which may, where the circumstances warrant it, allow the credit institution a limited period of time in which to comply with the limits.

#### *Article 112*

1 For the purposes of Articles 113 to 117, the term ‘guarantee’ shall include credit derivatives recognised under Articles 90 to 93 other than credit linked notes.

2 Subject to paragraph 3, where, under Articles 113 to 117, the recognition of funded or unfunded credit protection may be permitted, this shall be subject to compliance with the eligibility requirements and other minimum requirements, set out under Articles 90 to 93 for the purposes of calculating risk-weighted exposure amounts under Articles 78 to 83.

3 Where a credit institution relies upon Article 114(2), the recognition of funded credit protection shall be subject to the relevant requirements under Articles 84 to 89.

#### *Article 113*

1 Member States may impose limits more stringent than those laid down in Article 111.

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

3 Member States may fully or partially exempt the following exposures from the application of Article 111:

- a asset items constituting claims on central governments or central banks which, unsecured, would be assigned a 0 % risk weight under Articles 78 to 83;
- b asset items constituting claims on international organisations or multilateral development banks which, unsecured, would be assigned a 0 % risk weight under Articles 78 to 83;
- c asset items constituting claims carrying the explicit guarantees of central governments, central banks, international organisations, multilateral development banks or public sector entities, where unsecured claims on the entity providing the guarantee would be assigned a 0 % risk weight under Articles 78 to 83;
- d other exposures attributable to, or guaranteed by, central governments, central banks, international organisations, multilateral development banks or public sector entities, where unsecured claims on the entity to which the exposure is attributable or by which it is guaranteed would be assigned a 0 % risk weight under Articles 78 to 83;
- e asset items constituting claims on and other exposures to central governments or central banks not mentioned in point (a) which are denominated and, where applicable, funded in the national currencies of the borrowers;
- f asset items and other exposures secured, to the satisfaction of the competent authorities, by collateral in the form of debt securities issued by central governments or central banks, international organisations, multilateral development banks, Member States' regional governments, local authorities or public sector entities, which securities constitute claims on their issuer which would be assigned a 0 % risk weighting under Articles 78 to 83;
- g asset items and other exposures secured, to the satisfaction of the competent authorities, by collateral in the form of cash deposits placed with the lending credit institution or with a credit institution which is the parent undertaking or a subsidiary of the lending institution;
- h asset items and other exposures secured, to the satisfaction of the competent authorities, by collateral in the form of certificates of deposit issued by the lending credit institution or by a credit institution which is the parent undertaking or a subsidiary of the lending credit institution and lodged with either of them;
- i asset items constituting claims on and other exposures to institutions, with a maturity of one year or less, but not constituting such institutions' own funds;
- j asset items constituting claims on and other exposures to those institutions which are not credit institutions but which fulfil the conditions referred to in Annex VI, Part 1, point 85, with a maturity of one year or less, and secured in accordance with the same point;
- k bills of trade and other similar bills, with a maturity of one year or less, bearing the signatures of other credit institutions;
- l covered bonds falling within the terms of Annex VI, Part 1, points 68 to 70;
- m pending subsequent coordination, holdings in the insurance companies referred to in Article 122(1) up to 40 % of the own funds of the credit institution acquiring such a holding;
- n asset items constituting claims on regional or central credit institutions with which the lending credit institution is associated in a network in accordance with legal or

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- statutory provisions and which are responsible, under those provisions, for cash# clearing operations within the network;
- o exposures secured, to the satisfaction of the competent authorities, by collateral in the form of securities other than those referred to in point (f);
  - p loans secured, to the satisfaction of the competent authorities, by mortgages on residential property or by shares in Finnish residential housing companies, operating in accordance with the Finnish Housing Company Act of 1991 or subsequent equivalent legislation and leasing transactions under which the lessor retains full ownership of the residential property leased for as long as the lessee has not exercised his option to purchase, in all cases up to 50 % of the value of the residential property concerned;
  - q the following, where they would receive a 50 % risk weight under Articles 78 to 83, and only up to 50 % of the value of the property concerned:
    - (i) exposures secured by mortgages on offices or other commercial premises, or 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; and
    - (ii) exposures related to property leasing transactions concerning offices or other commercial premises;

for the purposes of point (ii), until 31 December 2011, the competent authorities of each Member State may allow credit institutions to recognise 100 % of the value of the property concerned. At the end of this period, this treatment shall be reviewed. Member States shall inform the Commission of the use they make of this preferential treatment;

- r 50 % of the medium/low#risk off#balance#sheet items referred to in Annex II;
- s subject to the competent authorities' agreement, guarantees other than loan guarantees which have a legal or regulatory basis and are given for their members by mutual guarantee schemes possessing the status of credit institutions, subject to a weighting of 20 % of their amount; and
- t the low#risk off#balance#sheet items referred to in Annex II, to the extent that an agreement has been concluded with the client or group of connected clients under which the exposure may be incurred only if it has been ascertained that it will not cause the limits applicable under Article 111(1) to (3) to be exceeded.

Cash received under a credit linked note issued by the credit institution and loans and deposits of a counterparty to or with the credit institution which are subject to an on# balance sheet netting agreement recognised under Articles 90 to 93 shall be deemed to fall under point (g).

For the purposes of point (o), the securities used as collateral shall be valued at market price, have a value that exceeds the exposures guaranteed and be either traded on a stock exchange or effectively negotiable and regularly quoted on a market operated under the auspices of recognised professional operators and allowing, to the satisfaction of the competent authorities of the Member State of origin of the credit institution, for the establishment of an objective price such that the excess value of the securities may be verified at any time. The excess value required shall be 100 %. It shall, however, be 150 % in the case of shares and 50 % in the case of debt securities issued by institutions, Member State regional governments or local authorities other than those referred to in sub#point (f), and in the case of debt securities issued by multilateral development banks other than those assigned a 0 % risk weight under Articles 78 to 83. Where there is a mismatch between the maturity of the exposure and the maturity of the credit protection, the collateral shall not be recognised. Securities used as collateral may not constitute credit institutions' own funds.

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For the purposes of point (p), the value of the property shall be calculated, to the satisfaction of the competent authorities, on the basis of strict valuation standards laid down by law, regulation or administrative provisions. Valuation shall be carried out at least once a year. For the purposes of point (p), residential property shall mean a residence to be occupied or let by the borrower.

Member States shall inform the Commission of any exemption granted under point (s) in order to ensure that it does not result in a distortion of competition.

#### *Article 114*

1 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.

For these purposes, ‘fully adjusted exposure value’ means that calculated under Articles 90 to 93 taking into account the credit risk mitigation, volatility adjustments, and any maturity mismatch (E\*).

Where this paragraph is applied to a credit institution, points (f), (g), (h), and (o) of Article 113(3) shall not apply to the credit institution in question.

2 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).

Competent authorities shall be satisfied as to the suitability of the estimates produced by the credit institution for use for the reduction of the exposure value for the purposes of compliance with the provisions of Article 111.

Where a credit institution is permitted to use its own estimates of the effects of financial collateral, it shall do so on a basis consistent with the approach adopted in the calculation of capital requirements.

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.

3 A credit institution that is permitted to use the methods described in paragraphs 1 and 2 in calculating the value of exposures for the purposes of Article 111(1) to (3), shall conduct periodic stress tests of their credit-risk concentrations, including in relation to the realisable value of any collateral taken.

These periodic stress tests shall address risks arising from potential changes in market conditions that could adversely impact the credit institutions' adequacy of own funds and risks arising from the realisation of collateral in stressed situations.

The credit institution shall satisfy the competent authorities that the stress tests carried out are adequate and appropriate for the assessment of such risks.

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In the event that such a stress test indicates a lower realisable value of collateral taken than would be permitted to be taken into account under paragraphs 1 and 2 as appropriate, the value of collateral permitted to be recognised in calculating the value of exposures for the purposes of Article 111(1) to (3) shall be reduced accordingly.

Such credit institutions shall include the following in their strategies to address concentration risk:

- a policies and procedures to address risks arising from maturity mismatches between exposures and any credit protection on those exposures;
- b policies and procedures in the event that a stress test indicates a lower realisable value of collateral than taken into account under paragraphs 1 and 2; and
- c policies and procedures relating to concentration risk arising from the application of credit risk mitigation techniques, and in particular large indirect credit exposures, for example to a single issuer of securities taken as collateral.

4 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.

#### *Article 115*

1 For the purposes of Article 111(1) to (3), Member States may assign a weighting of 20 % to asset items constituting claims on Member States' regional governments and local authorities where those claims would be assigned a 20 % risk weight under Articles 78 to 83 and to other exposures to or guaranteed by such governments and authorities claims on which are assigned a 20 % risk weight under Articles 78 to 83. However, Member States may reduce that rate to 0 % in respect of asset items constituting claims on Member States' regional governments and local authorities where those claims would be assigned a 0 % risk weight under Article 78 to 83 and to other exposures to or guaranteed by such governments and authorities claims on which are assigned a 0 % risk weight under Articles 78 to 83.

2 For the purposes of Article 111(1) to (3), Member States may assign a weighting of 20 % to asset items constituting claims on and other exposures to institutions with a maturity of more than one but not more than three years and a weighting of 50 % to asset items constituting claims on institutions with a maturity of more than three years, provided that the latter are represented by debt instruments that were issued by a institution and that those debt instruments are, in the opinion of the competent authorities, effectively negotiable on a market made up of professional operators and are subject to daily quotation on that market, or the issue of which was authorised by the competent authorities of the Member State of origin of the issuing institutions. In no case may any of these items constitute own funds.

#### *Article 116*

By way of derogation from Article 113(3)(i) and Article 115(2), Member States may assign a weighting of 20 % to asset items constituting claims on and other exposures to institutions, regardless of their maturity.

#### *Article 117*

1 Where an exposure to a client is guaranteed by a third party, or by collateral in the form of securities issued by a third party under the conditions laid down in Article 113(3)(o), Member States may:

- a treat the exposure as having been incurred to the guarantor rather than to the client; or

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- b treat the exposure as having been incurred to the third party rather than to the client, if the exposure defined in Article 113(3)(o) is guaranteed by collateral under the conditions there laid down.
- 2 Where Member States apply the treatment provided for in point (a) of paragraph 1:
- a where the guarantee is denominated in a currency different from that in which the exposure is denominated the amount of the exposure deemed to be covered will be calculated in accordance with the provisions on the treatment of currency mismatch for unfunded credit protection in Annex VIII;
  - b a mismatch between the maturity of the exposure and the maturity of the protection will be treated in accordance with the provisions on the treatment of maturity mismatch in Annex VIII; and
  - c partial coverage may be recognised in accordance with the treatment set out in Annex VIII.

#### *Article 118*

Where compliance by a credit institution on an individual or sub#consolidated basis with the obligations imposed in this Section is disapplied under Article 69(1), or the provisions of Article 70 are applied in the case of parent credit institutions in a Member State, measures must be taken to ensure the satisfactory allocation of risks within the group.

#### *Article 119*

By 31 December 2007, the Commission shall submit to the European Parliament and to the Council a report on the functioning of this Section, together with any appropriate proposals.

### *Section 6*

#### ***Qualifying holdings outside the financial sector***

#### *Article 120*

1 No credit institution may have a qualifying holding the amount of which exceeds 15 % of its own funds in an undertaking which is neither a credit institution, nor a financial institution, nor an undertaking carrying on activities which are a direct extension of banking or concern services ancillary to banking, such as leasing, factoring, the management of unit trusts, the management of data processing services or any other similar activity.

2 The total amount of a credit institution's qualifying holdings in undertakings other than credit institutions, financial institutions or undertakings carrying on activities which are a direct extension of banking or concern services ancillary to banking, such as leasing, factoring, the management of unit trusts, the management of data processing services, or any other similar activity may not exceed 60 % of its own funds.

3 The limits laid down in paragraphs 1 and 2 may be exceeded only in exceptional circumstances. In such cases, however, the competent authorities shall require a credit institution either to increase its own funds or to take other equivalent measures.

#### *Article 121*

Shares held temporarily during a financial reconstruction or rescue operation or during the normal course of underwriting or in an institution's own name on behalf of others



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shall not be counted as qualifying holdings for the purpose of calculating the limits laid down in Articles 120(1) and (2). Shares which are not financial fixed assets as defined in Article 35(2) of Directive 86/635/EEC shall not be included in the calculation.

*Article 122*

1 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.

2 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.

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- (1) First Council Directive 73/239/EEC of 24 July 1973 on the coordination of laws, regulations and administrative provisions relating to the taking-up and pursuit of the business of direct insurance other than life assurance (OJ L 228, 16.8.1973, p. 3). Directive as last amended by Directive 2005/1/EC.
- (2) Directive 2002/83/EC of the European Parliament and of the Council of 5 November 2002 concerning life assurance (OJ L 345, 19.12.2002, p. 1). Directive as last amended by Directive 2005/1/EC.
- (3) Directive 98/78/EC of the European Parliament and of the Council of 27 October 1998 on the supplementary supervision of insurance undertakings in an insurance group (OJ L 330, 5.12.1998, p. 1). Directive as last amended by Directive 2005/1/EC.