Directive 2009/111/EC of the European Parliament and of the Council of 16 September 2009 amending Directives 2006/48/EC, 2006/49/EC and 2007/64/EC as regards banks affiliated to central institutions, certain own funds items, large exposures, supervisory arrangements, and crisis management (Text with EEA relevance)

DIRECTIVE 2009/111/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

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(Text with EEA relevance)

THE EUROPEAN PARLIAMENT AND THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 47(2) thereof,

Having regard to the proposal from the Commission,

Having regard to the opinion of the European Economic and Social Committee[1],

Having regard to the opinion of the European Central Bank[2],

After consulting the Committee of the Regions,

Acting in accordance with the procedure laid down in Article 251 of the Treaty[3],

Whereas:

(1) In accordance with the European Council and Ecofin Conclusions and international initiatives such as the Group of Twenty (G-20) summit on 2 April 2009, this Directive represents a first important step to address shortcomings revealed by the financial crisis ahead of further initiatives announced by the Commission and set out in Commission Communication of 4 March 2009 entitled 'Driving European recovery'.

(2) Article 3 of 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[4] allows Member States to provide for special prudential regimes for credit institutions which are permanently affiliated to a central body since 15 December 1977, provided that those regimes were introduced into national law by 15 December 1979. Those time limits prevent Member States, especially those which acceded to the European Union since 1980, from introducing or maintaining such special prudential regimes for similarly affiliated credit institutions which were set up on their territories. It is therefore appropriate to remove the time limits set out in Article 3 of that Directive, in order to ensure equal conditions for competition between credit institutions in Member States.

The Committee of European Banking Supervisors should provide for guidelines in order to enhance the convergence of supervisory practices in this regard.

(3) Hybrid capital instruments play an important role in the ongoing capital management of credit institutions. Those instruments allow credit institutions to achieve a diversified capital structure and to access a wide range of financial investors. On 28 October 1998, the Basel Committee on Banking Supervision adopted an agreement on both the eligibility criteria and limits to inclusion of certain types of hybrid capital instruments in original own funds of credit institutions.

(4) It is therefore important to lay down criteria for those capital instruments to be eligible for original own funds of credit institutions and to align the provisions in Directive 2006/48/EC to that agreement. The amendments to Annex XII to Directive 2006/48/EC result directly from the establishment of those criteria. Original own funds referred to in Article 57(a) of Directive 2006/48/EC should include all instruments that are regarded under national law as equity capital, rank pari passu with ordinary shares during liquidation and fully absorb losses on a going-concern basis pari passu with ordinary shares. It should be possible for those instruments to include instruments providing preferential rights for dividend payment on a non-cumulative basis, provided that they are included in Article 22 of Council Directive 86/635/EEC of 8 December 1986 on the annual accounts and consolidated accounts of banks and other financial institutions[(5)], rank pari passu with ordinary shares during liquidation and fully absorb losses on a going-concern basis pari passu with ordinary shares. Original own funds referred to in Article 57(a) of Directive 2006/48/EC should also include any other instrument under a credit institution's statutory terms taking into account the specific constitution of mutuals, cooperative societies and similar institutions and which are deemed equivalent to ordinary shares in terms of their capital qualities in particular as regards loss absorption. Instruments that do not rank pari passu with ordinary shares during liquidation or which do not absorb losses on a going-concern basis pari passu with ordinary shares should be included in the category of hybrids referred to in Article 57(ca) of Directive 2006/48/EC.

(5) In order to avoid disruption of markets and to ensure continuity in overall levels of own funds it is appropriate to provide for specific transitional arrangements for the new regime on capital instruments. Once recovery is assured, the quality of original own funds should be further enhanced. In this regard, the Commission should report to the European Parliament and the Council together with any appropriate proposals by 31 December 2011.

(6) For the purpose of strengthening the crisis management framework of the Community, it is essential that competent authorities coordinate their actions with other competent authorities and, where appropriate, with central banks in an efficient way, including with the aim of mitigating systemic risk. In order to strengthen the efficiency of the prudential supervision of a banking group on a consolidated basis, supervisory activities should be coordinated in a more effective manner. Colleges of Supervisors should therefore be established. The establishment of Colleges of Supervisors should not affect the rights and responsibilities of the competent authorities under Directive 2006/48/

EC. Their establishment should be an instrument for stronger cooperation by means of which competent authorities reach agreement on key supervisory tasks. The Colleges of Supervisors should facilitate the handling of ongoing supervision and emergency situations. The consolidating supervisor should, in association with the other members of the college, be able to decide to organise meetings or activities that are not of general interest and should therefore be able to streamline the attendance as appropriate.

(7) The mandates of competent authorities should take into account, in an appropriate way, the Community dimension. Competent authorities should therefore duly consider the effect of their decisions on the stability of the financial system in all other Member States concerned. Subject to national law, that principle should be understood as a broad objective for promoting financial stability across the European Union and should not legally bind competent authorities to achieve a specific result.

(8) The competent authorities should be able to participate in colleges established for the supervision of credit institutions having their parent in a third country. The Committee of European Banking Supervisors should, where necessary, provide for guidelines and recommendations in order to enhance the convergence of supervisory practices pursuant to Directive 2006/48/EC. In order to avoid inconsistencies and regulatory arbitrage, which could result from differences in the approaches and rules applied by the various colleges and the application of discretion by Member States, guidelines on the procedures and rules governing colleges should be developed by the Committee of European Banking Supervisors.

(9) Article 129(3) of Directive 2006/48/EC should not change the allocation of responsibilities between competent supervisory authorities on a consolidated, sub-consolidated and individual basis.

(10) Information deficits between the home and the host competent authorities may prove detrimental to the financial stability in host Member States. The information rights of host supervisors, in particular in a crisis involving significant branches, should therefore be reinforced. For that purpose, the notion of significant branches should be defined. The competent authorities should transmit information which is essential for the pursuance of the tasks of central banks and of Ministries of Finance with respect to financial crises and systemic risk mitigation.

(11) The current supervisory arrangements should be subject to further developments. Colleges of Supervisors are a further and important step forward in streamlining European Union's supervisory cooperation and convergence.

(12) Cooperation between supervisory authorities, dealing with groups and holdings and their subsidiaries and branches, by means of colleges is a phase in a development towards further regulatory convergence and supervisory integration. Trust between supervisors and respect for their respective responsibilities is essential. In the event of a conflict between members of a college linked to those different responsibilities, neutral and independent advice, mediation and conflict-resolving mechanisms at Community level are essential.

(13) The crisis in international financial markets has demonstrated that it is appropriate to examine further the need for reform of the regulatory and supervisory model of the European Union's financial sector.

(14) The Commission announced in its Communication of 29 October 2008 entitled 'From financial crisis to recovery: A European framework for action', that it had set up a group of experts, chaired by Mr Jacques de Larosière (the de Larosière Group), to consider the organisation of European financial institutions to ensure prudential soundness, the orderly functioning of markets and stronger European cooperation on financial stability oversight, early warning mechanisms and crisis management, including the management of cross-border and cross-sectoral risks, and also to look at cooperation between the European Union and other major jurisdictions to help safeguard financial stability at the global level.

(15) In order to achieve the necessary level of supervisory convergence and cooperation at the European Union level, and to underpin the stability of the financial system, further wide-ranging reforms of the regulatory and supervisory model of the European Union's financial sector are highly needed and should be put forward swiftly by the Commission, with due consideration of the conclusions presented by the de Larosière Group on 25 February 2009.

(16) By 31 December 2009, the Commission should report to the European Parliament and the Council and propose appropriate legislation needed to tackle the shortcomings identified regarding the provisions related to further supervisory integration, taking into account that a stronger role for a European Union level supervisory system should be achieved by 31 December 2011.

(17) Excessive concentration of exposures to a single client or group of connected clients may result in an unacceptable risk of loss. Such a situation could be considered prejudicial to the solvency of a credit institution. The monitoring and control of the large exposures of a credit institution should therefore be an integral part of its supervision.

(18) The current large exposures regime dates back to 1992. Therefore, the existing requirements on large exposures set out in Directive 2006/48/EC and in Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions[(6)] should be reviewed.

(19) Since credit institutions in the internal market are engaged in direct competition, the essential rules for the monitoring and control of the large exposures of credit institutions should be further harmonised. In order to reduce the administrative burden on credit institutions, the number of options for Members States as far as large exposures are concerned should be reduced.

(20) In determining the existence of a group of connected clients and thus exposures constituting a single risk, it is also important to take into account risks arising from a common source of significant funding provided by the credit institution or investment firm itself, its financial group or its connected parties.

(21) While it is desirable to base the calculation of the exposure value on that provided for the purposes of minimum own funds requirements, it is appropriate to adopt rules for the monitoring of large exposures without applying risk weightings or degrees of risk. Moreover, the credit risk mitigation techniques applied in the solvency regime were designed with the assumption of a well-diversified credit risk. In the case of large exposures dealing with single name concentration risk, credit risk is not well-diversified. The effects of those techniques should therefore be subject to prudential safeguards. In this context, it is necessary to provide for an effective recovery of credit protection for the purposes of large exposures.

(22) Since a loss arising from an exposure to a credit institution or an investment firm can be as severe as a loss from any other exposure, such exposures should be treated and reported in the same manner as any other exposures. However, an alternative quantitative limit has been introduced to alleviate the disproportionate impact of such an approach on smaller institutions. In addition, very short-term exposures related to money transmission including the execution of payment services, clearing, settlement and custody services to clients are exempt to facilitate the smooth functioning of financial markets and of the related infrastructure. Those services cover, for example, the execution of cash clearing and settlement and similar activities to facilitate settlement. The related exposures include exposures which might not be foreseeable and are therefore not under the full control of a credit institution, inter alia, balances on inter-bank accounts resulting from client payments, including credited or debited fees and interest, and other payments for client services, as well as collateral given or received.

(23) The provisions related to external credit assessment institutions (ECAIs) under Directive 2006/48/EC should be consistent with Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies[(7)]. In particular, the Committee of European Banking Supervisors should review its guidelines on the recognition of ECAIs to avoid duplication of work and reduce the burden of the recognition process where an ECAI is registered as a credit rating agency (CRA) at Community level.

(24) It is important that the misalignment between the interest of firms that ‘re-package’ loans into tradable securities and other financial instruments (originators or sponsors) and firms that invest in these securities or instruments (investors) be removed. It is also important that the interests of the originator or sponsor and the interests of investors be aligned. To achieve this, the originator or sponsor should retain a significant interest in the underlying assets. It is therefore important for the originators or the sponsors to retain exposure to the risk of the loans in question. More generally, securitisation transactions should not be structured in such a way as to avoid the application of the retention requirement, in particular through any fee or premium structure or both. Such retention should be applicable in all situations where the economic substance of a securitisation according to the definition of Directive 2006/48/EC is applicable, whatever legal structures or instruments are used to obtain this economic substance. In particular where credit risk is transferred by securitisation, investors should make their

decisions only after conducting thorough due diligence, for which they need adequate information about the securitisations.

(25) The measures to address the potential misalignment of those structures need to be consistent and coherent in all relevant financial sector regulation. The Commission should put forward appropriate legislative proposals to ensure such consistency and coherence. There should be no multiple applications of the retention requirement. For any given securitisation it suffices that only one of the originator, the sponsor or the original lender is subject to the requirement. Similarly, where securitisation transactions contain other securitisations as an underlying, the retention requirement should be applied only to the securitisation which is subject to the investment. Purchased receivables should not be subject to the retention requirement if they arise from corporate activity where they are transferred or sold at a discount to finance such activity. Competent authorities should apply the risk weight in relation to non-compliance with due diligence and risk management obligations in relation to securitisation for non-trivial breaches of policies and procedures which are relevant to the analysis of the underlying risks.

(26) In their Declaration on Strengthening the Financial System of 2 April 2009, the leaders of the G20 requested the Basel Committee for Banking Supervision and authorities to consider due diligence and quantitative retention requirements for securitisation by 2010. In view of those international developments, and in order best to mitigate systemic risks arising from securitisation markets, the Commission should, before the end of 2009 and after consulting the Committee of European Banking Supervisors, decide whether an increase of the retention requirement should be proposed, and whether the methods of calculating the retention requirement deliver the objective of a better alignment of the interests of the originators or sponsors and the investors.

(27) Due diligence should be used in order properly to assess the risks arising from securitisation exposures for both the trading book and the non-trading book. In addition, due diligence obligations need to be proportionate. Due diligence procedures should contribute to building greater confidence between originators, sponsors and investors. It is therefore desirable that relevant information concerning the due diligence procedures is properly disclosed.

(28) Member States should ensure that competent authorities have sufficient personnel and resources to comply with their supervisory obligations under Directive 2006/48/EC and that employees involved in the supervision of credit institutions in accordance with that Directive have appropriate knowledge and experience for the duties assigned.

(29) Annex III to Directive 2006/48/EC should be adapted in order to clarify certain provisions with a view to enhancing the convergence of supervisory practices.

(30) Recent market developments have highlighted the fact that liquidity risk management is a key determinant of the soundness of credit institutions and their branches. The criteria set out in Annex V and XI to Directive 2006/48/EC should be reinforced in order to align those provisions to the work conducted by the Committee of European Banking Supervisors and the Basel Committee on Banking Supervision.

(31) The measures necessary for the implementation of Directive 2006/48/EC should be adopted in accordance with Council Decision 1999/468/EC of 28 June 1999 laying down the procedures for the exercise of implementing powers conferred on the Commission[(8)].

(32) In particular the Commission should be empowered to amend Annex III of Directive 2006/48/EC in order to take account of developments on financial markets or in accounting standards or requirements which take account of Community legislation or with regard to convergence of supervisory practice. Since those measures are of general scope and are designed to amend non-essential elements of Directive 2006/48/EC, they must be adopted in accordance with the regulatory procedure with scrutiny provided for in Article 5a of Decision 1999/468/EC.

(33) The financial crisis has revealed a need for a better analysis of and response to macro-prudential problems, which lie at the interface between macroeconomic policy and financial system regulation. This will include a need to examine: measures that mitigate the ups and downs of the business cycle, including the need for credit institutions to build counter-cyclical buffers in good times that can be used during a downturn, which may include the possibility of building up additional reserves, 'dynamic provisioning' and the possibility to reduce capital buffers during difficult times, thus ensuring adequate availability of capital over the cycle; the rationale underlying the calculation of capital requirements in Directive 2006/48/EC; supplementary measures to risk-based requirements for credit institutions to help constrain the build-up of leverage in the banking system.

(34) By 31 December 2009, the Commission should therefore, review Directive 2006/48/EC as a whole to address those issues and present a report to the European Parliament and the Council and any appropriate proposals.

(35) In order to ensure financial stability, the Commission should review and report on measures to enhance transparency of OTC markets, to mitigate the counterparty risks and more generally to reduce the overall risks, such as by clearing of credit default swaps through central counterparties (CCPs). The establishment and development of CCPs in the EU subject to high operational and prudential standards and effective supervision should be encouraged. The Commission should submit its report to the European Parliament and the Council together with any appropriate proposals, taking into account parallel initiatives at the global level as appropriate.

(36) The Commission should review and report on the application of Article 113(4) of Directive 2006/48/EC including whether exemptions should be a matter of national discretion. The Commission should submit that report to the European Parliament and the Council together with any appropriate proposals. The exemptions and options should be abolished where there is no demonstrated need for their maintenance with a view of achieving single set of consistent rules across the Community.

(37) The specific characteristics of microcredit should be taken into account in the risk assessment, and the development of microcredit should be promoted. Furthermore, given the low development of microcredit, the development of adequate rating systems

should be promoted, including the development of standard rating systems adapted to the risks of microcredit activities. Member States should endeavour to ensure that the prudential regulation and supervision of micro-credit activities at national level are proportionate.

(38) Since the objectives of this Directive, namely the introduction of rules concerning the taking up and pursuit of the business of credit institutions, and their prudential supervision, cannot be sufficiently achieved by the Member States because it requires the harmonisation of a multitude of different rules existing in the legal systems of the various Member States and can therefore be better achieved at Community level, the Community may adopt measures, in accordance with the principle of subsidiarity as set out in Article 5 of the Treaty. In accordance with the principle of proportionality, as set out in that Article, this Directive does not go beyond what is necessary in order to achieve those objectives.

(39) In accordance with point 34 of the Interinstitutional agreement on better law-making[(9)], Member States are encouraged to draw up, for themselves and in the interest of the Community, their own tables illustrating, as far as possible, the correlation between this Directive and the transposition measures, and to make them public.

(40) Directives 2006/48/EC, 2006/49/EC and 2007/64/EC[(10)] should therefore be amended accordingly,

HAVE ADOPTED THIS DIRECTIVE:

(**1**) Opinion of 24 March 2009 (not yet published in the Official Journal).

(**2**) OJ C 93, 22.4.2009, p. 3.

(**3**) Opinion of the European Parliament of 6 May 2009 (not yet published in the Official Journal) and Council Decision of 27 July 2009.

(**4**) OJ L 177, 30.6.2006, p. 1.

(**5**) OJ L 372, 31.12.1986, p. 1.

(**6**) OJ L 177, 30.6.2006, p. 201.

(**7**) See page 1 of this Official Journal.

(**8**) OJ L 184, 17.7.1999, p. 23.

(**9**) OJ C 321, 31.12.2003, p. 1.

(**10**) OJ L 319, 5.12.2007, p. 1.