LIBA - ISDA - SIFMA Europe
JOINT ASSOCIATION RESPONSE TO
COMMISSION SERVICES STAFF WORKING DOCUMENT ON
POSSIBLE FURTHER CHANGES TO THE CRD
7 September 2009

Introduction

The Associations (LIBA, ISDA and SIFMA Europe) offer their response to the Commission Services Staff Working Document.

We have not addressed all four sections of the Commission document and have concentrated exclusively on section 1 (through the cycle provisioning) and section 3 (options and discretions). Within the response to section 3 we have not commented on the aspects of the proposals relating to real estate.

Therefore this document includes:

- An overview of key points that have emerged in our analysis of the Commission Staff Working Document.
- Impact assessment, questions 1-3
- Dynamic provisioning, Section 1, questions 4-13
- National options and discretions, Section 3, questions 16-18
- An annotated commentary of our responses to the Commission’s consultative text on national options and discretions (Annex 3 of the Commission’s Staff Working Document). For ease of reference, the annotations have been highlighted in yellow.

Key messages

Short consultation period

The comments that we submit need to be read in the context of the extremely limited time available to prepare our response. There are a number of issues on which there has been insufficient time available to analyse all the possible effects or to gather data on potential impact. While we acknowledge policymakers’ desire not to lose momentum, we are disappointed that the Commission concluded it was unable to

---

1 LIBA (84360841127-33), SIFMA (10968031348-66), and ISDA (46643241096-93)
give stakeholders more time to consider these proposals fully, thereby supporting the principle of effective regulation and in line with good policy development processes.

**Timing of implementation**

We welcome the fact that the Commission raises the issue of the potential need for phased implementation.

As the Commission is aware, there is a significant, possibly unprecedented, range and volume of regulatory changes in the course of development. The timing of implementation is very important, as there are potential consequences for the wider economy. The renewal of economic activity within the EU, as well as globally, is still at an early stage. We welcome signals from the EU and other groupings, including the G20, recognising that there needs to be a carefully phased implementation of new regulations and capital requirements so that macro economic recovery can be sustained.

At a more practical firm level, however, there are significant systems changes that will be required to address the regulatory initiatives. Accelerated timescales for implementation will create competition for systems as well as capital resources and could undermine rather than guarantee a smooth transition to a revised regulatory framework. In our view there needs to be a careful assessment of the timetable so that industry has the scope to achieve the deadlines that are set.

In order to determine the most appropriate timing for introduction of the proposals we think the following must to be taken into account; the need for:

- Firms to have a better understanding of the amount of regulatory capital that will be required by the package to date and recapitalisation programmes are complete.
- Global agreement on any package and timing of introduction of countercyclical measures.
- A fuller understanding of the likely accounting approach to provisioning to determine the extent of any regulatory requirements to be addressed.
- Firms to have a better understanding of the systems changes that would be necessary. Sufficient time should be allowed for the implementation of those changes, particularly given the likely parallel changes that will need to be made in relation to accounting.

See questions 2 and 3, pages 5 and 6; and page 15

**Impact assessment**

We are pleased to note that the consultation asks for impact data on the proposals contained within this consultation, as well as for the cumulative effect of the changes to date. It has not, however, been possible to provide a detailed analysis of the impact of the regulatory changes in the time available, or on the dynamic provisioning proposals without further information on the calibration.

There are very many “moving parts” to the regulatory proposals and many of the individual pieces envisaged may appear persuasive in regulatory terms if taken in isolation. However, a full assessment needs to be taken to determine whether the overall burden is appropriate and to ensure that different elements of the proposals do not conflict or duplicate each other. Without an overarching impact assessment it
will also be impossible to assess whether there is any potential for systemically adverse consequences or weaknesses to be introduced.

See questions 1 to 3, pages 5 and 6, and page 15

International agreement

We strongly believe that an EU consultation on dynamic provisioning should only take place as part of a wider consultation on counter-cyclical measures, so that the cumulative effect and appropriateness can be properly assessed. Moreover, such consultation should parallel that of the Basel Committee on Banking Supervision to ensure that the EU is taking a consistent and coherent approach to that being taken globally. In addition, since the accounting framework is also being revised, it would be appropriate to wait until there is a clearer understanding of the likely accounting outcome before determining what, if any, additional regulatory requirements are necessary to address procyclicality.

See page 7

Separation of regulation and accounting

We would not recommend the inclusion of dynamic provisioning, as proposed in this consultation, within the financial statements. The needs of users, of financial statements, whose focus is on the current financial position of firms, are different from those of regulators. It is important that the users of financial statements are able to assess the accounting information and compare the results across firms globally.

See page 7

Interaction with the regulatory framework

If dynamic provisioning, as proposed, is thought to be an appropriate part of a package of counter-cyclical measures then further consideration needs to be given to how it would fit within the regulatory framework. In particular we would highlight its interaction with Article 57. For IRB firms the Article 57(q) calculation using a through the cycle PD and a downturn LGD would already appear to address the issue and therefore there is a risk of double counting. For standardised firms/portfolios further consideration is necessary with regard to the interaction of dynamic provisioning with the calculation of the existing capital charges and the provisioning elements incorporated within Tier 2. The stress testing requirements would also be a relevant consideration and further clarity would be required on the mechanics of the proposal (i.e. the exclusion of dynamic provisions from capital and any reversal calculations).

See page 8

Use of the accounting balance sheet

Should this dynamic provisioning proposal form part of a package of counter-cyclical measures, further consideration is necessary regarding the use of the accounting balance sheet as the basis for calculation, as this will not necessarily reflect the risk position of the firm. In particular we think further consideration needs to be given to credit risk mitigation.

See page 8
Issues for consideration regarding expected loss as part of the package of counter-cyclical measures

We think that further issues need to be taken into consideration if EL provisioning is to form part of the package of counter-cyclical measures:

- Gap analysis on the current regulatory framework
- Whether the same approach has to be applied to all firms
- Whether any approach should be formula driven or principles based
- If formula driven, whether the basis for calculation should be the regulatory or accounting balance sheet
- The need for impact assessment

See pages 9 and 10
Question 1: What impact would the changes proposed in each section of this paper have on your activities or activities of firms in your jurisdiction, including costs linked to increase in regulatory capital and other compliance costs?

It is impossible to determine the impact of the dynamic provisioning proposal without more information on how the parameters will be calibrated and the objective of that calibration. At this relatively early stage of implementation, it is also too early to tell the procyclical effect of the CRD and the Basel framework (particularly as some countries have yet to fully implement and because the Basel I floors have been in operation).

However, we are concerned that dynamic provisioning will further increase the gap between regulated entities and non-regulated entities and further disintermediation. A particular concern is a reduction in transparency that could result from the overly complex proposals. Furthermore the provisioning requirements would involve significant systems changes (alongside those that would be necessary to introduce a revised accounting framework).

We also think that any impact should only be assessed on the package of countercyclical measures, once those have been agreed at a global level and should take account of changes to the accounting framework and the aspects of the framework that already address this issue. For example the EL/provisions assessment in Article 57(q), which with through the cycle PDs and downturn LGDs addresses or possibly exceeds the objectives of dynamic provisioning, and the procyclicality stress testing capital requirements.

Question 2: Do you have any views about any aggregate impact of the proposed changes to capital requirements?

Question 3: What is the optimal timing for these measures? Should their application be sequenced?

We are pleased to note that the consultation asks for impact data on the proposals contained within this consultation as well as for the cumulative effect of the changes to date. However, given the extremely tight timetable for this consultation over the summer period, it has not been possible to draw together firms’ assessments, although we understand that firms are providing information to their supervisors and bilaterally.
Discussion with Members indicates that they are concerned about the overall capital impact of these proposals, as well as those adopted or in the process of being agreed, and the timing of introduction. Although there are signs of increasing economic activity, we note that the G20 communiqué indicates that changes should not be made until recovery is assured. Given the magnitude of the changes to date, firms would have to plan capital issuance well ahead of the implementation date and spread it over a considerable period. Therefore we strongly support a review of the timing of the introduction of the changes should to ensure that their implementation does not damage the sustainability of the improvements seen to date.

Key areas of the package to date where Members expect significant impacts are:

- Securitisation retention and due diligence
- Re-securitisation
- Trading book

Serious consideration needs to be given to the appropriate timing for introduction of the dynamic provisioning proposals and they should not be adopted until:

- Firms have a better understanding of the amount of regulatory capital that will be required by the package to date and recapitalisation programmes are complete.
- Global agreement has been reached on any package and timing of introduction of countercyclical measures has been reached.
- Agreement has been reached on the accounting approach to provisioning to determine what market failure still needs to be addressed.
- Firms have a better understanding of the systems changes that would be necessary to deliver any provisioning requirements. Sufficient time should be allowed for the implementation of those changes, particularly given the likely parallel changes that will need to be made in relation to accounting.
Key messages

International agreement and timing of consultation

While we appreciate the Authorities’ desire to maintain momentum in addressing the issues arising from the financial crisis, we strongly believe that an EU consultation on dynamic provisioning should only take place as part of a wider consultation on counter-cyclical measures, so that their cumulative impact and appropriateness can be properly assessed. Moreover such consultation should only take place in parallel with that of the Basel Committee on Banking Supervision, to ensure that the EU is taking a consistent approach to that being taken globally. It is not apparent to us that there are any particular EU specificities that require a separate regional approach to be taken to address procyclicality. It is also beneficial to global firms to operate under a single coherent approach.

In addition we are aware that the International Accounting Standards Board (IASB) is developing its proposals on an expected loss approach to impairment of financial assets. While we note that their request for information would indicate an expected cash flow approach it would seem beneficial to wait until there is a clearer idea as to the nature of their proposals before determining additional regulatory requirements to address procyclicality, particularly given the inter-linkage with Article 57. Based on the IASB request for advice, it is difficult to see how the accounting and regulatory provisioning proposals could be aligned, given the conceptual differences between the two (the IASB request for information indicates a possible life-cycle approach, whereas dynamic provisioning considers the economic cycle).

With these issues in mind, our response focuses mainly on the problems associated with what is proposed, so that these can be factored in to a wider debate on counter-cyclical measures.

Separation of regulation and accounting

We would not recommend the inclusion of dynamic provisioning within the accounting profit and loss and balance sheet and note the Commission’s comment in this regard. We regard the separation from accounting as fundamental. Reporting of dynamic provisions within the accounts would not provide users, whose needs are distinct from those of the regulators, with information on the current financial position of the institution, and so could undermine the validity of the income statement and the meaningfulness and comparability of financial statements across firms globally. Investors’ and other stakeholders’ confidence in the information provided may
therefore be compromised. Users should be able to access unbiased accounting numbers in order to be able to assess them appropriately and compare results across firms globally.

However we are concerned to note the comment that indicates the Commission would hope that the regulatory approach to dynamic provisioning would be acceptable under accounting standards. We think that this would be an inappropriate outcome, as the reduced transparency that would result would not lead to a more stable system.

Interaction with other parts of the regulatory framework

It is not clear how this proposal would interact with the requirement in Article 57(q) for IRB firms to compare provisions and expected loss, or with the inclusion of value adjustments in 57(e) and general banking risks in 57(c).

The comparison between expected loss and provisions in Article 57(q) is very similar to the approach of Method 2 in the proposal, except that $\beta$ is replaced with the firms’ estimate of EL. We note that regulators are increasingly seeking, and firms are already adopting, a through the cycle approach to probability of default (PD). This, combined with downturn loss given default (LGD) will already address procyclicality by reducing the volatility of EL and possibly go further than a provisioning approach that looks at average losses and provisions over the cycle. Therefore any regulatory approach for IRB firms should first assess what is not being addressed by the EL/provisioning calculation, otherwise there will be double counting, particularly as any shortfall of provisions to EL is already taken as a deduction from capital.

For firms/portfolios on the standardised approach further consideration will also be required since provisions are netted from exposure value prior to determining risk weighted assets (which effectively incorporate both EL and UL) and collective provisions can still be included in Tier 2 capital. Therefore any consideration as to the inclusion/exclusion from capital must take account of the regulatory capital approach taken by the firm.

Furthermore the framework already requires recession related stress testing to be undertaken under Pillar 1, with an explicit requirement to hold capital against the risks under Pillar 2. In the UK, a one in twenty five year event is used as the basis of the stress test. Imposing dynamic provisioning will conflict with this approach because firms will effectively adjust capital resources whilst simultaneously adjusting capital requirements as a result of stress testing. Therefore it is important to ensure that the regulatory requirements act in a coherent manner.

These interactions need to be addressed otherwise there is a risk that the proposal introduces further volatility into the capital requirements.

Finally there is a lack of clarity over how dynamic provisioning fits into the framework. The consultation indicates that dynamic provisions should not form part of the capital base, but it is unclear how that would be achieved – by replacing firms’ provisions, imposing a capital requirement or deducting from the capital base. Further consideration is required. In addition it is not clear how the reversals would be addressed in Method 2, if provisions exceed the dynamic provisioning calculation or indeed in Method 1. We would be interested in understanding what lessons the Spanish have learned from the operation of their system in relation to this aspect.

Use of the accounting balance sheet

The use of accounting balance sheet as the basis of determining dynamic provisions on a formulaic basis will likely lead to a mis-statement of the amount of provisions

---

2  50:50 from Tiers 1 and 2
required. This is because it will fail to take account of credit risk mitigation rightly attributed regulatory relief under the regulatory framework. For example, according to current accounting rules, repos are accounted for on-balance sheet, i.e. the full amount of the asset and collateral will be recorded rather than the net amount (or in the case of the regulatory framework an adjusted net amount)\(^3\). As a result provisions against these transactions will likely overstate the amount of risk to which the institution is exposed. In addition the risk mitigating effects of collateral will not be reflected, nor the majority of securitisations. Given the potential changes to the accounting framework in relation to de-recognition, classification and valuation of financial instruments, we believe that this issue should be given further consideration once the likely outcome becomes clearer.

Without further detail on the calibration of the dynamic provisioning model and sufficient time to conduct the impact assessment it is not possible to quantify the effect of this issue. However, firms indicate that this could be significant.

**Issues for consideration regarding expected loss as part of the package of countercyclical measures**

We think that if expected loss measure is considered an appropriate part of the package of counter-cyclical measures, much greater consideration needs to be given to the basis on which it is done. To that end we think the following issues should be considered:

1. Gap analysis on the current regulatory framework should be undertaken to determine what extra is required to meet regulatory objectives.

2. Whether the same approach has to apply to all firms – i.e. whether IRB firms should be treated differently to standardised firms. Since the IRB firms already go some way towards calculating an EL measure on a through the cycle basis it may be possible to develop a system that builds on the parameters that firms already produce, using actual losses/provisions as an offset to reverse out the requirement at the low points of the cycle. Obviously if a differentiated approach were to be developed for IRB firms, then a methodology would need to be applied to standardised firms.

3. If it is thought necessary to apply the same approach to all firms then consideration should be given as to whether this needs to be :
   a. formula driven, or
   b. principles based

If formula based then any approach has to be proportionate and capable of being applied by the full range of firms and therefore should not be too complex or require the level of information/systems established for IRB firms for their capital calculation. The benefits of such an approach would be consistency, transparency and relative simplicity. However, such an approach would fail to take account of the risk management capabilities of the firms, or ownership structure and would be less risk sensitive.

It is also potentially possible for expected loss provisions to be prepared on the basis of principles, i.e. akin to stress testing requirements. While such an approach would obviously bring with it some element of judgement by both firms and supervisors, it would be more risk sensitive (i.e. potentially capable of taking account of the sensitivity of different business lines to the credit cycle), could take account of the firms’ risk management record and could be

\(^3\) We note that the accounting in this area is under review and that a different approach may be taken to repos going forward.
integrated into the firms capital management processes. Concerns over comparability could be addressed through appropriate disclosures.

3. If formula driven or principles based further consideration should be given to whether the basis should be:
   a. the accounting balance sheet; or
   b. the regulatory balance sheet prior to risk adjustment

There are pros and cons associated with both:

<table>
<thead>
<tr>
<th>Accounting balance sheet</th>
<th>Regulatory balance sheet</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Pros</strong></td>
<td><strong>Pros</strong></td>
</tr>
<tr>
<td>o provisioning process already in place</td>
<td>o firms already reconcile their regulatory and accounting balance sheets and therefore would be able to identify those exposures subject to impairment provisioning.</td>
</tr>
<tr>
<td><strong>Cons</strong></td>
<td><strong>Cons</strong></td>
</tr>
<tr>
<td>o Likely to overstate the risk on the balance sheet as it is not a risk based measure, e.g collateralised exposures</td>
<td>o It would not be able to account for all credit risk mitigants for example where they are recognised through LGD rather than EAD.</td>
</tr>
<tr>
<td>o Further consideration required as to how off balance sheet exposures would be addressed.</td>
<td></td>
</tr>
</tbody>
</table>

4. A thorough impact assessment has been undertaken.

**Consultation questions**

**Question 4:** The Commission services suggest that the through the cycle value adjustment should not count as regulatory capital (See ANNEX 1, suggested amendment to Article 57), do you agree?

Noting our comments above regarding the need to consult on the broader package of counter-cyclical measures, we can see the logic in excluding dynamic provisions from capital, since this is the basis of Article 57(q). However, the mechanics for excluding dynamic provisions in capital is unclear replacing firms’ provisions with dynamic provisions, a variable capital requirement that takes account of the firm’s provisions, or a deduction from capital that takes account of the firm’s provisions. We do not think it is necessary to construct the counter-cyclical capital buffer as a provision; it could equally be a capital requirement or deduction. For example unrated securitisation positions may either be treated as a 1250% risk weight or a capital deduction. Further review of this issue would be required
As noted above, we also think that further consideration is required regarding interaction of a counter-cyclical provision/charge with other aspects of the capital framework. In particular we think that further thought is required in relation to the provision in Article 57 (e) that requires the difference between provisions and EL to adjust capital.

We would reiterate that we believe that any counter-cyclical measures should not have any impact on the numbers presented in the financial statements.

**Question 5:** Should off-balance sheet items be captured under the formula for through the cycle expected loss provisioning, given that ‘provisions’ for off-balance sheet items are not recognised in all relevant accounting standards? Should only assets be subject to an impairment test be subject to through the cycle expected loss provisioning? (See ANNEX 1, suggested article 74a(2))

Mindful of our view in the key messages we would note that international accounting standards would require provisions to be taken against off balance sheet items such as commitments. However we think it would be highly inappropriate to apply the 100% conversion factor suggested to these items prior to applying any formula, as this would fail to recognise the contingent nature of the exposures or actions that firms would take to manage them. In addition it would fail to acknowledge the self liquidating nature of some of the transactions such as trade finance.

If the approach suggested is intended to address perceived weaknesses in the accounting for certain off balance sheet items such as SPVs we would note that the accounting framework is being revised – both de-recognition and consolidation are under review – and the CRD brought in a more conservative treatment in relation to firms’ exposures to such vehicles, for example through the treatment of liquidity facilities, which has been amended further in the CRD II legislation.

If dynamic provisioning is considered to be an appropriate part of a package of counter-cyclical measures, then we would agree that care should be taken to ensure that it would not be applied to assets where there would be double counting of EL. Therefore we think only assets subject to an impairment test should be subject to through the cycle expected loss provisioning.

**Question 6:** At this point, the suggestion is not to include the option for competent authorities to allow internal methods to determine expected losses across an economic cycle. As an alternative to the regulatory approach to calculate counter-cyclical factors, would it be desirable to allow firms’ internal methodologies (to be validated by supervisors)?

Acknowledging our concerns regarding the proposal, yes it would be desirable.

If firms are not allowed to use internal methods, or at the very least firm specific parameters, then the result will not be risk sensitive and will fail to take account of firms’ ability to manage risk, as noted above.

We acknowledge that allowing firms to use their own models is likely to reduce comparability. However, a robust regulatory challenge process and appropriate disclosures can be made to address that issue. We would note that IRB banks are already subject to such challenge regarding their models and the parameters within them, and that EL feeds into the existing under/over provisioning measure in Article 57.
Question 7: Should the exposure class of Article 86 (i.e. for credit institutions subject to the IRB approach) be used irrespective of the fact that the credit institution may be under the Standardised Approach? It may be noted that a mapping between exposure class under the Standardised Approach and under the IRB is already used in the prudential reporting system of some Member States. As an alternative, should countercyclical parameters be defined for the 16 exposure classes under the Standardised Approach? (See ANNEX 1, suggested Article 74a (1))

It would be possible for standardised banks to map across their exposure classes to those of the IRB.

Question 8: Please give your views on the following approaches:

1) the Spanish model of through the cycle expected loss provisioning;
2) a simplified Spanish model.

In particular, we would welcome views on the relative merits of both options in terms of the building up of provisions in a graduated manner over time (see ANNEX 1, suggested Annex IXb)

As noted above, we strongly believe that it is inappropriate to be developing legislation for dynamic provisioning in isolation from other potential counter-cyclical measures, in advance of international agreement on this issue and prior to gaining a full understanding of the future shape of the accounting requirements.

That said, we would note the following:

- As currently drafted we think that the application of the Spanish model would appear to require the provision to be charged every year rather than the difference between the provisions in each year. We presume this is not what was intended. Further clarity is also required on what would happen in the year of adoption and whether there would be transitional provisions.
- Both methods require further clarity, particularly in respect of what the parameters are trying to achieve and how they will be calibrated to make an informed judgement.
- We think that it will be extremely difficult to develop the a and ß factors. Since many jurisdictions do not maintain credit registers, we are uncertain as to where the information required will be derived.
- We think both proposals are extra-territorial, since they require the development of provisioning parameters for third countries. We think that this is highly inappropriate and could result in protectionist measures being taken elsewhere, particularly as this is proposal is not part of a globally agreed package. In addition the data issues in determining the parameters for these third countries and making appropriate judgements in relation to appropriate provisioning will be more problematic than for EU jurisdictions.
- As noted above, since they are formulaic and based on the accounting balance sheet, both methodologies will be relatively blunt instruments and will fail to take account of firms’ risk management capabilities, organisation and risk profile.
- It is also impossible to determine whether either approach would lead to a sensible outcome since the detail of how the parameters will be calibrated is not yet available.
Therefore we strongly recommend that this proposal is deferred until the Basel Committee consults on counter-cyclical measures.

**Question 9:** Should new risk categories (as suggested above) be introduced along the lines of the Spanish system, or alternatively, should the current risk categories of the CRD (e.g. credit quality steps in Annex VI) be used? (See ANNEX 1, suggested Annex IXb)

As noted above, we think it is inappropriate to develop this proposal at this time and we think that considerable further review should be given to this proposal if it is to be included in any package of counter-cyclical measures.

Mindful of the above, since it is unclear as to the basis of determination of the assets that would fall into the criteria from the Spanish approach, we do not think it is possible to comment as to whether this would be better or worse than using the categories in the CRD. For standardised firms a new categorisation would introduce a further requirement to map exposures across to the categories in the Spanish approach. For IRB firms either proposal would require firms to map exposures across to a new categorisation.

**Question 10:** Is the ‘location of the borrower’ (as opposed to the booking of the exposure) the right approach, with a view to avoiding regulatory arbitrage (see Annex 1, suggested Annex IXb 2)

Given the large number of outstanding questions with the proposed models, we think that it is too early to determine the appropriate approach in this area.

**Question 11:** Will the data to determine counter-cyclical factors be easily available?

We believe that it is likely to be problematic to obtain publicly available and consistent data across all jurisdictions. Rating agencies will obviously have some loss data but this will only relate to rated instruments and not to all exposures. We also understand that some universities hold default and loss data but this will only cover a subset of the assets and jurisdictions that would need to be considered. Furthermore, credit registers are not consistently held across all jurisdictions. Firms will, of course, have their own loss and provisioning data, but this will not necessarily have the long run of data required for this exercise stored according to the exposure classes in the CRD or the risk categories considered.

**Question 12:** Please give your views on the methodologies for calculating the through the cycle expected loss provisions at consolidated level (see ANNEX 1, amended Article 73)

We think there will be considerable difficulties with applying the proposal at the consolidated and sub-consolidated level.

Accounting consolidation and regulatory consolidation do not necessarily coincide in terms of the entities covered and accounting consolidations are not necessarily undertaken at the regulatory sub-consolidated level. In addition, where consolidation nets exposures across entities we are uncertain as to which location would be required to be used. The issue of intra-group exposures also needs to be considered.
We are also concerned that the application at the entity level as well as the consolidated level could create capital problems at the solo level in that the sum of the parts could be more than the whole.

Further consideration is required of the level of application of any such measures.

**Question 13: Please give your views on the scope of disclosure requirements for through the cycle expected loss provisioning. (See ANNEX 1, suggested amendment to Annex XII (17))**

We would agree that any disclosure relating to counter-cyclical measures should be made in Pillar 3 and not form part of the accounts, as it would cause confusion for users. We also believe that any disclosures should only be made at the consolidated level as they would not provide users with valuable information at the entity level.

Given our view of the perceived problems with the approaches suggested, we question whether the detail of disclosures will give meaningful information to users as they will not be reflective of firms’ risks. However we would be pleased to work with the Commission in developing appropriate disclosures once a comprehensive package of counter-cyclical measures becomes clearer.
Introduction and Summary

This section addresses the Commission’s questions and proposed amendments in the area of National Discretions and Options.

Therefore this section includes:

(a) An overview of key points that have emerged in our analysis of the text.

(b) Our response to the three questions posed by the Commission in Section 3 of their Staff Working Document.

(c) An annotated commentary of our responses to the Commission’s co consultative text on national options and discretions (Annex 3 of the Commission’s Staff Working Document). For Ease of reference, the annotations have been highlighted in yellow.

(a) Key points

- We support the majority of the amendments proposed by the Commission but we also expect the Commission to ensure that there is an effective impact assessment of the very many changes that will be proposed. In this context we note that there are some amendments (all falling in Directive 2006/49/EC) where we are unable to offer comment as we have not had sufficient time to analyse the possible effects of the changes.

- In noting that there are a number of options that will be withdrawn from the end of 2012, we remind the Commission that this is a very tight deadline allowing little scope to firms to manage transition of their systems efficiently. It is also one element that will add to the cumulative impact of the wide spectrum of changes that will be imposed on industry in a short timescale. An impact assessment is essential.

- We believe that a number of the amendments highlight the need for CEBS to proceed with swift and transparent processes in the assessments it is asked to undertake and the guidelines that it is asked to draw up. It will need to be resourced and structured accordingly.
There are some amendments where we seek clarification from the Commission as present drafting appears to produce an unclear outcome. We have highlighted these points below.

We would be grateful to understand which amendments the Commission proposes to take forward under the co-decision procedure and which (if any) will be subject to a Comitology procedure.

(b) **Questions posed by the Commission in Section 3**

**Question 16: Is this suggested scope of maximum harmonisation in 2006/48/EC and 2006/49/EC appropriate?**

The Associations support the proposal put forward by the Commission on the basis that the proposal for maximum harmonisation cover areas that are already “fully harmonised”, namely areas of technical calculation in Pillars 1 and 3. We appreciate the fact that Member State competent authorities will not, in these circumstances, be able to impose any “gold plating” or super-equivalent requirements in these areas.

**Question 17: Is the suggested prudential treatment for both residential and commercial real estate is sufficiently sound?**

The Associations do not comment on this aspect of the proposals.

**Question 18: Is the suggested timeline (2012) for a single definition of default (i.e. 90 days) is appropriate.**

With the caveat that we do not comment on the potential effect on mortgage portfolios, the Associations agree that the transition period will otherwise be suitable.

(c) **Textual amendments to the CRD re options and discretions in Annex 3**

Please see annex, attached.
ANNEX 3

DRAFT TEXT FOR AMENDMENTS TO THE CRD TO REMOVE NATIONAL OPTIONS AND DISCRETIONS

The purpose of the following suggested amendments is to specify the scope of 'maximum harmonisation' in Directive 2006/48/EC (Article 157a) and in Directive 2006/49/EC (Article 49a)

Article 157a

"157a. By 31 December 2012, Member States shall remove all national provisions that are stricter than those laid down in Title V, Chapter 2, Section 2, Subsection 3, Title V, Chapter 2, Sections 3 to 6 and Title V, Chapter 5 of this Directive." Support.

Article 49a

"By 31 December 2012, Member States shall remove all national provisions that are stricter than those laid down in Chapter V, Sections 1 and 4 of this Directive." Support.

The amendments in this section remove options and national discretions from Directive 2006/48/EC.

1. Article 72(3) is replaced by the following:

"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 to the extent that they are included within comparable disclosures provided on a consolidated basis by a parent undertaking established in a third country." Support.

2. Article 80(3) is replaced by the following:

"3. For the purposes of calculating risk-weighted exposure amounts for exposures to institutions, Member States shall decide whether to adopt the method shall be 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." Support.

3. Article 81(3) is replaced by the following:

"If an ECAI seeks to be recognised as eligible in more than one Member State, the Committee of European Banking Supervisor shall carry out the 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 referred to in paragraph 2." Support.
NB, We seek, however, clarification that the national supervisor may continue to recognise an ECAI, if the recognition is sought at the level of its jurisdiction.

4. Article 82(2) is replaced by the following:

"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. For ECAIs referred to in Article 81(3), the Committee of European Banking Supervisor shall make the determination referred to in paragraph (1).". Support.

5. The second subparagraph of Article 84(2) is replaced by the following:

"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, working together in accordance with Article 129(2), may allow, in a way consistent with the structure of the group and its risk management processes and methodologies, minimum requirements of Annex VII, Part 4 to be met by the parent and its subsidiaries considered together." Support.

6. The second subparagraph of Article 89(1) is replaced by the following:

"This paragraph shall not prevent the competent authorities of other Member States from allowing the application of the rules of Subsection 1 (standardised approach) for equity exposures referred to in points (f) and (g) which have been allowed for this treatment in other Member States.". Support.

Article 97(3) is replaced by the following:

"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 processes. For ECAIs referred to in Article 97(3), the Committee of European Banking Supervisor shall carry out the evaluation process.". Support.

NB, We seek clarification that the national supervisor may continue to recognise an ECAI, if the recognition is sought at the level of its jurisdiction.

7. Article 98(2) is replaced by the following:

"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. For ECAIs referred to in Article 97(3), the Committee of European Banking Supervisor shall make the determination referred to in paragraph (1).". Support.

8. Article 102(4) is replaced by the following:

"4. Competent authorities may allow credit institutions to use a combination of approaches subject to compliance with the requirements set out in Annex X, Part 4.". Support.

9. Article 104(3) is replaced by the following:

"3. For certain business lines, 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 if the competent authorities approve that the conditions there specified are met.". Support.

10. Article 105(4) is replaced by the following:
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, working together in accordance with Article 129(2), shall allow, in a way consistent with the structure of the group and its risk management processes and methodologies, may the qualifying criteria set out in Annex X, Part 3 to be met by the parent and its subsidiaries considered together.”. **Support**

11. Article 122 is amended as follows:

(a) The first paragraph is replaced by the following:

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

(b) The second paragraph is replaced by the following:

"2. The Member States may provide that the competent authorities are not to apply. Credit institutions may exceed 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 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.". **Support**

12. Article 154(6) is replaced by the following:

"6. Until 31 December 2012, the competent authorities of the Member States may exempt from the IRB treatment certain equity exposures held by credit institutions and EU subsidiaries of credit institutions in that Member State at 31 December 2007. Competent authorities shall make public the categories of equity exposures which benefit from this treatment.". **Support but suggest the transition date be reconsidered**

13. Annex III, Part 3 is amended as follows:

(a) The paragraph below Table 1 is replaced by the following:

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

(b) A new paragraph is introduced below Table 2:

"The Commission shall review the implementation of this provision and Table 2 by 31 December 2012.". **On the basis that this is a review of implementation only, we support**

14. Annex III, Part 6 is amended as follows:

(a) Point 7 is replaced by the following:

"7. The exposure value shall be calculated as the product of a times Effective EPE, as follows:

\[\text{Exposure value} = a \times \text{Effective EPE}\]

where:
alpha (a) shall be no less than 1.4, but competent authorities may require a higher a, and effective EPE shall be computed by estimating expected exposure (EEt) as the average exposure at future date t, where the average is taken across possible future values of relevant risk factors. The model estimates EE at a series of future dates t1, t2, t3 etc.”;

(b) The first sentence of point 12 is replaced by the following:
"12. Notwithstanding point 7, competent authorities may permit credit institutions may use their own estimates of a, subject to a floor of 1.2 where a shall equal the ratio of internal capital from a full simulation of CCR exposure across counterparties (numerator) and internal capital based on EPE (denominator)."

We seek clarification on this amendment. We believe that the intention of this amendment is to ensure that when firms are permitted to use their own estimate of alpha, that they may use an alpha value no lower than 1.2. For firms where the value of alpha is set by the supervisor it shall be no less than 1.4. However, by deleting “competent authorities may permit” it is possible that any firm will have the vires to use 1.2 as it will not be subject to supervisory approval. We do not think that this is the outcome that is intended.

15. In Annex III, Part 7 the last item of point (c)(ii) is replaced by the following:
" — NGR = ‘net-to-gross ratio’: at the discretion of the competent authorities either: (i) separate calculation: the quotient of the net replacement cost for all contracts included in a legally valid bilateral netting agreement with a given counterparty (numerator) and the gross replacement cost for all contracts included in a legally valid bilateral netting agreement with that counterparty (denominator), or — (ii) aggregate calculation: the quotient of the sum of the net replacement cost calculated on a bilateral basis for all counterparties taking into account the contracts included in legally valid netting agreements (numerator) and the gross replacement cost for all contracts included in legally valid netting agreements (denominator)". Support

16. Annex VI, Part 1 is amended as follows:
(a) Point 5 is replaced by the following:
"5. When the competent authorities of a third country which apply supervisory and regulatory arrangements at least equivalent to those applied in the Community assign a risk weight which is lower than that indicated in point 1 to 2 to exposures to their central government and central bank denominated and funded in the domestic currency, competent authorities shall allow their credit institutions to risk weight such exposures in the same manner. To this end, the Committee of European Banking Supervisors shall conduct an assessment of the supervisory and regulatory arrangements of the third country in question."

This amendment, and the amendment to point 11 (below) will lead to the necessity for a CEBS process that will apply to every Third Country Regime. It is important to note in this context, that while harmonisation is a legitimate goal, this change puts a high priority on CEBS delivering a swift, transparent and effective process so that firms’ businesses are not impeded. Thus we believe it will be important to be very clear on the process that CEBS will utilize in its assessments, including the timings and consultation of the competent authorities.

It is also important to note that there will be cases where a particular competent authority has much deeper knowledge and understanding of a specific Third Country regime, arising from its bilateral relationships and it is important that this knowledge and understanding is fed into the assessment;

(b) Point 11 is replaced by the following:
"11. When competent authorities of a third country jurisdiction which apply supervisory and regulatory arrangements at least equivalent to those applied in the Community treat exposures to regional governments and local authorities as exposures to their central government and there is no difference in risk between such exposures owing to the specific revenue-raising powers of regional government and local authorities and to specific institutional arrangements to reduce the risk of default exist, the competent authorities shall allow their credit institutions to risk weight exposures to such regional governments and local authorities in the same manner. To this end, the Committee of European Banking Supervisors shall conduct an assessment of the supervisory and regulatory arrangements of the third country in question.": Please see comments relating to point 5, immediately above.

(c) Point 14 is replaced by the following:

"14. Subject to the discretion of competent authorities The competent authorities shall draw up and make public a list of domestic public sector entities exposures which may be treated as exposures to institutions, or the criteria for identifying such domestic public entities. Exposures to public sector entities may be treated as exposures to institutions provided that the respective public sector entity is on the list drawn up by a competent authority ["the competent authorities"] or fulfils the criteria for identifying public entities eligible for treating them as institutions. Exercise of this discretion by competent authorities is independent of the exercise of discretion as specified in Article 80(3). The preferential treatment for short-term exposures specified in points 31, 32 and 37 shall not be applied.";

We highlight, above, two possible language errors.

More substantively, the first part of the amendment implies that each competent authority will draw up its own separate list of PSEs which will then be made public. However, the next part of the amendment implies that a firm may treat an exposure to PSEs as an exposure to an institution if either the PSE is on the public list, or if the PSE fulfils the criteria for identifying public entities eligible for treating them as institutions. This suggests that firms have their own discretion to identify relevant PSEs. We would appreciate clarity that this is the intention of the amendment.

(d) Point 15 is replaced by the following:

"15. In cases where there is no difference in risk between exposures to domestic public sector entities and exposures to the central government in whose jurisdiction they are established because owing to the existence of an appropriate guarantee by the central government, the competent authorities shall draw up and make public a list of those public sector entities exposures to which may be treated as exposures to central government, or the criteria for identifying such public entities. In exceptional circumstances, exposures to public sector entities may be treated as exposures to the central government in whose jurisdiction they are established where in the opinion of the competent authorities there is no difference in risk between such exposures because of the existence of an appropriate guarantee by the central government."; Support

(e) Point 16 is replaced by the following:

"16. When the discretion to treat exposures to public-sector entities are treated as exposures to institutions or as exposures to the central government in whose jurisdiction they are established is exercised by the competent authorities of one in one Member State, the competent authorities of another Member State shall allow their credit institutions to risk-weight exposures to such public-sector entities in the same manner."; Support
(f) Point 17 is replaced by the following:

"17. When competent authorities of a third country jurisdiction which apply supervisory and regulatory arrangements at least equivalent to those applied in the Community treat exposures to its public sector entities as exposures to institutions, and there is no difference in risk between such exposures and those of institutions, the competent authorities shall allow their credit institutions to risk weight exposures to such public sector entities in the same manner. To this end, the Committee of European Banking Supervisors shall conduct an assessment of the supervisory and regulatory arrangements of the third country in question.";

Support

(g) Point 23 is deleted; Support

(h) Section 6.2 is deleted; Support

(i) The section number and title of Section 6.3 is deleted; Support

(j) Point 27 is replaced by the following:

"27. For exposures to institutions incorporated in countries where the central government is unrated, the risk weight shall be not more than 100 %."); Support

(k) Sections 6.4 and 6.5 are deleted; Support

(l) The section number and title of section 6.6 is deleted; Support

(m) Point 37 is replaced by the following:

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

(n) In point 40, the introductory phrase is replaced by the following:

"40. Where an Exposure to an institution in the form of minimum reserves required by the ECB or by the central bank of a Member State to be held by a credit institution may be risk-weighted as, Member States may permit the assignment of the risk weight that would be assigned to exposures to the central bank of the Member State in question provided;"; Discretion is removed from the national competent authority and a preferential treatment is made available for the individual firm. Support.

We are not offering comments on issues relating to commercial or residential mortgage lending. Hence, points (o) to (q) inclusive are not shown here.

(r) Point 63 is replaced by the following:

"63. Nonetheless, until 31 December 2012, where a past due item is fully secured by forms of collateral other than those eligible for credit risk mitigation purposes, a 100% risk weight may be assigned subject to the discretion of competent authorities based upon strict operational criteria to ensure the good quality of collateral when value adjustments reach 15% of the exposure gross of value adjustments."; We would like to clarify with the Commission whether the intention is that from 2013 onwards, a firm would be able to apply the preferential treatment of past due items as the national discretion has been removed, or would it actually mean that the entire treatment of past due items would expire?

(s) Point 64 is replaced by the following:
"64. Exposures indicated in points 45 to 50 shall be assigned a risk weight of 100% net of value adjustments if they are past due for more than 90 days. Until 31 December 2012, if value adjustments are no less than 20% of the exposure gross of value adjustments, the risk weight to be assigned to the remainder of the exposure may be reduced to 50% at the discretion of competent authorities.

Lack of clarity is the same as that in Point (r) above and (u) below and we ask that the Commission confirm its intent.

(t) Point 66 is replaced by the following:

"Subject to the discretion of competent authorities, exposures that are associated with particularly high risks, including where appropriate associated with particularly high risks such as investments in venture capital firms, and private equity investments, speculative real estate programs and hedge funds, shall be assigned a risk weight of 150%. When assessing whether an exposure is associated with particularly high risks, competent authorities shall, on the basis of CEBS guidelines, take into account the following risk characteristics:

(a) there is a high risk of loss as a result of a default of the obligor; or
(b) it is impossible to assess adequately whether the exposure falls under point (a)."

In considering this amendment we would note that, clearly not all hedge funds can be regarded as high risk counterparts. Nor will all investments in venture capital firms be high risk. Therefore we welcome what we perceive to be the recognition that it is not merely the category of the exposure that should determine whether an exposure is subject to the 150% risk weighting.

We would, though, recommend that the drafting should emphasise the importance of the risk characteristics more than at present and that the risk characteristics were less ambiguously drafted.

For example, losses will not always occur it is not clear whether (a) above means that there is a high risk of loss only because the obligor is at high risk of defaulting? It is also possible that characteristic (b) is drawn too widely as this characteristic could apply to a great many exposures from many different sectors, not least the unrated SMEs.

(u) In point 67, the introductory phrase is replaced by the following:

"Until 31 December 2012, competent authorities may permit non past due items to be assigned a 150% risk weight according to the provisions of this Part and for which value adjustments have been established to be assigned a risk weight of:

It is not clear whether the time limit inserted in the directive means that the higher risk weight will become obligatory from 1 January 2013 (as opposed to being applied on a discretionary basis by the competent authority) or whether the higher risk weight itself will expire. We would be grateful for clarification.

Additionally, if the time limit means that this treatment expires at the end of 2012 we would note that it creates one more cumulative strain on firms' systems in order to be able to adapt according to a very tight transition period. The expiry date of end 2012 appears needlessly tight and we would ask for a careful, cumulative, impact study to assess the application of this date in both this amendment and in others through the text.

(v) Second sentence of point 68 (e) is replaced by the following:

"The competent authorities may recognise Loans secured by commercial real estate may be recognised as eligible where the Loan to Value ratio of 60% is
exceeded up to a maximum level of 70 % if the value of the total assets pledged as collateral for the covered bonds exceed the nominal amount outstanding on the covered bond by at least 10 %, and the bondholders' claim meets the legal certainty requirements set out in Annex VIII."

(w) Point 78 is replaced by the following:

"78. If a competent authority approves a third country CIU as eligible, as set out in point 77(a), then a competent authority in another Member State may make use of this recognition without conducting its own assessment. Competent authorities shall allow their credit institutions to use a collective investment undertaking established in a third country provided that the conditions in point 77(a) are met. To this end, the Committee of European Banking Supervisors shall conduct an assessment of the supervisory and regulatory arrangements of the third country in question."

As we noted above, it is important to note in this context, that while harmonisation is a legitimate goal, this change puts a high priority on CEBS delivering a swift, transparent and effective process so that firms' businesses are not impeded. Thus we believe it will be important to be very clear on the process that CEBS will utilize in its assessments, including the timings and consultation of the competent authorities.

(x) Point 85 is deleted.

17. In Annex VI, Part 3, point 17 is replaced by the following:

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

18. Annex VII, Part 1 is amended as follows:

(a) The second paragraph of point 6 is replaced by the following:

"The competent authorities shall authorise a credit institution generally to assign preferential risk weights of 50% to exposures in category 1, and a 70% risk weight to exposures in category 2, provided the competent authority is satisfied, on the basis of guidelines provided by the Committee of European Banking Supervisors, that the credit institution’s underwriting characteristics and other risk characteristics are substantially strong for the relevant category."

(b) The third paragraph of point 13 is replaced by the following:

"By way of derogation from point (b), competent authorities may waive the requirement that the exposure be unsecured in respect of collateralised credit facilities linked to a wage account. In this case amounts recovered shall not be taken into account in the LGD estimate."

(c) Point 18 is replaced by the following:

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

19. Annex VII, Part 2 is amended as follows:
(a) The second sentence of point 5 is replaced by the following:

"For dilution risk, however, on the basis of guidelines provided by the Committee of European Banking Supervisors, competent authorities may recognise as eligible unfunded credit protection providers other than those indicated in Annex VIII, Part 1 as set out in point 5.”;

Support

(b) The fourth sentence of point 7 is replaced by the following:

"Competent authorities may recognise as eligible unfunded credit protection providers other than those indicated in Annex VIII, Part 1 as set out in point 5.”;

Support

(c) The last sentence of point 12 is replaced by the following:

"Member States shall provide that competent authorities may require all credit institutions in their jurisdiction to use maturity (M) for each exposure as set out under point 13.”;

The deletion of "all" creates an ambiguity and we ask the Commission to clarify the outcome it intends.

(d) The second paragraph of Point 14 is replaced by the following:

"In addition, for other short-term exposures specified by the competent authorities—which are not part of the credit institution's ongoing financing of the obligor, M shall be at least one-day:

Exposures to institutions arising from foreign exchange settlements;

Self-liquidating short-term trade financing transactions, import and export letters of credit and similar transactions with a residual maturity of up to one year;

Exposures arising from settlement of securities purchases and sales within the usual delivery period or two business days”; and

Exposures arising from cash settlements by wire transfer and settlements of electronic payment transactions and prepaid cost, including overdrafts arising from failed transactions that do not exceed a short, fixed agreed number of business days.

The Committee of European Banking Supervisors shall establish guidelines on the implementation of this provision. A careful review of the particular circumstances shall be made in each case.”;

We note that the creation of regulatory “lists” can be fraught with difficulty over time (for example the definition of financial instruments in the former Investment Services Directive). However, it seems likely that there will be a list created through this process. We believe that there are valid additions that should be made to such a list so that the following items (noted below) forming a subset of non-trade exposures that share similar characteristics of the exempted trade products: they are being short-term in nature, non-revolving and not forming part of the ongoing financing of the obligor should additionally be exempted from the 1 year maturity floor. Therefore, we propose that CEBS reviews whether there are valid additions that should be made to such a list. This would be warranted where the benefits of additional liquidity to a market are more than the benefit in terms of additional capital requirements.

- Non revolving facilities maturing in less than 1 year under which there is no possibility of rolling over without another credit application/assessment at the same level of vigour of any new credit application. The maturity floor for such exposures
should be set at 90 days.

- Drawings under uncommitted facilities maturing in less than 1 year in which the bank can unilaterally refuse rollover upon maturity. The maturity floor for such exposures should be set at 90 days.

- Short-term exposures to banks maturing in less than 1 year which are non-revolving by their nature. The maturity floor for such exposures should be set at 1 day.

Although these products may not be self liquidating, the fact that the exposure becomes due and repayable upon maturity implies that any attempt to rollover due to inability of the borrower to "liquidate" the exposure will result in a default event once the 90 days past due threshold is reached. This risk is already captured by the PD of the borrower and should not be compounded by setting a 1-year floor for M.

In addition, a similar argument applies for the treatment of short-term exposures to banks that are, by their nature, non-revolving. Under the Standardised approach, CRD (Annex VI part 1 point 6) treats exposures to banks that have a maturity of up to 3 months more favourably than longer-dated exposures, recognising thereby their diminished risk characteristics.

(e) Point 15 is replaced by the following:
"15. The competent authorities may allow for exposures to corporates situated in the Community and having consolidated sales and consolidated assets of less than EUR 500 million, the use of M as set out in point 12 shall be used. Until 31 December 2012, competent authorities may replace EUR 500 million total assets with EUR 1000 million total assets for corporates which primarily invest in real estate."; We support the first part of the amendment but the second part of the amendment relates to real estate and we do not offer comment.

(f) Point 20 is replaced by the following:
"20. Unfunded credit protection may be recognised as eligible by adjusting PDs subject to point 22. For dilution risk, where credit institutions do not use own estimates of LGD, this shall be subject to compliance with articles 90 to 93; for this purpose, on the basis of guidelines established by the Committee of European Banking Supervisor, competent authorities may recognise as eligible unfunded protection providers other than those indicated in Annex VIII, Part 1. To this end, competent authorities shall publish the list of those other eligible protection providers together with the reasons why these are considered suitable for this purpose."; Support

(g) The following section number and heading is inserted is added:
"3.4. Mutual recognition and other provisions"; Support

(h) The following points 28 and 29 are added:
"28. When the discretion contained in points 5, 7 and 20 is exercised by the competent authority of one Member State, the competent authorities of other Member States shall allow their credit institutions to use as eligible those unfunded credit protection providers recognised by that competent authority. Support"
29. Pending further harmonisation, the Commission shall review the implementation of this provision by 31 December 2011." Revision clauses are good due process but this date is too soon. The effectiveness of the review will be undermined.

20. Annex VII, Part 4 is amended as follows:

(a) In point 44:

(i) the fifth paragraph is replaced by the following:

"Until 31 December 2012, in the case of retail exposures and exposures to public sector entities (PSE) the competent authorities shall set a number of days past due as specified in point 48."; Support

(ii) The seventh paragraph replaced by the following:

"In all cases, the exposure past due shall be above a threshold defined by the competent authorities and which reflecting a reasonable level of risk. The Committee of European Banking Supervisor shall establish guidelines on the determination of that threshold. Member States shall provide that the competent authorities may adapt this threshold in accordance with Article 84(2)."; Support

(b) Point 48 is replaced by the following:

"48. Until 31 December 2012, for retail and PSE exposures, the competent authorities of each Member States shall set the exact number of days past due that all credit institutions in its jurisdiction shall abide by under the definition of defaults set out in §44, for exposures to such counterparts situated within this Member State. The specific number shall fall within 90-180 days and may differ across product lines. Until 31 December 2012, for exposures to such counterparts situated in the territories of other Member States, the competent authorities shall set a number of days past due which is not higher than the number set by the competent authority of the respective Member State."; Support

(c) Point 56 is replaced by the following:

"56. Member States shall provide that, if credit institutions can demonstrate to their competent authorities that for data that have been collected prior to the date of implementation of this Directive appropriate adjustments have been made to achieve broad equivalence with the definition of default or loss, competent authorities shall allow, on the basis of guidelines established by the Committee of European Banking Supervisors, the credit institutions some flexibility in the application of the required standards for data."; Support

(d) Point 66 is replaced by the following:

"66. Irrespective of whether a credit institution is using external, internal, or pooled data sources, or a combination of the three, for its PD estimation, the length of the underlying historical observation period used shall be at least five years for at least one source. If the available observation period spans a longer period for any source, and this data is relevant, this longer period shall be used. This point also applies to the PD/LGD Approach to equity. Member States may allow credit institutions Subject to the approval of competent authorities, credit institutions which are not permitted to use own estimates of LGDs or conversion factors may have use, when they implement the IRB Approach, relevant data covering a period of two years. The period to be covered shall increase by one year each year until relevant data cover a period of five years."; It is not clear what the Commission intends by this amendment. We would be grateful for clarification.
(e) Point 71 is replaced by the following:

"71. Irrespective of whether a credit institution is using external, internal or pooled data sources or a combination of the three, for their estimation of loss characteristics, the length of the underlying historical observation period used shall be at least five years for at least one source. If the available observation spans a longer period for any source, and these data are relevant, this longer period shall be used. A credit institution need not give equal importance to historic data if it can convince its competent authority that more recent data is a better predictor of loss rates. Member States may allow credit institutions to have, when they implement the IRB Approach, relevant data covering a period of two years. The period to be covered shall increase by one year each year until relevant data cover a period of five years."; As for point 66 above.

(f) Point 86 is replaced by the following:

"86. Estimates of LGD shall be based on data over a minimum of five years. Notwithstanding point 73, a credit institution needs not give equal importance to historic data if it can demonstrate to its competent authority that more recent data is a better predictor of loss rates. Member States may allow credit institutions to have, when they implement the IRB Approach, relevant data covering a period of two years. The period to be covered shall increase by one year each year until relevant data cover a period of five years."; As for points 66 and 71 above.

(g) Point 95 is replaced by the following:

"95. Estimates of conversion factors shall be based on data over a minimum of five years. Notwithstanding point 87, a credit institution need not give equal importance to historic data if it can demonstrate to its competent authority that more recent data is a better predictor of draw downs. Member States may allow credit institutions to have, when they implement the IRB Approach, relevant data covering a period of two years. The period to be covered shall increase by one year each year until relevant data cover a period of five years."; As for points 66, 71 and 95 above.

21. In Annex VIII, Part 1 is amended as follows:

(a) Points 15 to 19 are replaced by the following: The Associations are not responding on issues relating to the real estate markets so we do not offer comments.

(b) Point 20 is replaced by the following:

"20. The competent authorities may recognise as eligible collateral amounts receivable linked to a commercial transaction or transactions with an original maturity of less than or equal to one year. Eligible receivables do not include those associated with securitisations, sub-participations or credit derivatives or amounts owed by affiliated parties."; Support

(c) Point 21 is replaced by the following:

"21. The competent authorities may shall recognise as eligible collateral physical items of a type other than those types indicated in points 13 to 19 if satisfied as to the following:
In principle we support the purpose of the amendment but by amplifying the conditions the new text introduces new policy and we consider that the conditions are unduly restrictive, given that physical collateral will have value even though the liquidation period may be variable. As presently drafted it is likely that the shipping and aircraft markets might be excluded from eligible physical collateral and this would clearly be inappropriate given that considerable value is vested in these assets.

(a) the existence of liquid markets for the disposal of the collateral in an expeditious and economically efficient manner. In case of moveable assets, this condition need not to be assessed only with respect to the local market. The institution must be able to demonstrate that the relevant market for the collateral is sufficiently liquid. Criteria relevant to the fulfilment of this condition shall include the frequency of the transactions made in the relevant market. The assessment of this condition shall be reviewed when information indicates that the quantity of transactions or the collateral prices may have declined materially; and

(b) the existence of well-established publicly available market prices for the collateral. The market prices may be considered well-established if they come from reliable sources of information such as public indexes and reflect the price of the transactions under normal conditions. To be considered publicly available, these prices must be disclosed, easily accessible, and obtainable regularly and without any undue administrative or financial burden; and

(c) that the credit institution has analysed the empirical evidence, including the market prices, time required to realise the collateral and the recovery rates. The credit institution must be also able to demonstrate that there is no evidence that the net prices it receives when the assets taken as collateral are realised deviates significantly from these market prices. The fulfilment of these requirements and those specified in Annex VIII, Part 2, point 10 must be sufficiently documented. In case of material volatility in the market prices, the institution must be able to demonstrate that its valuation of the collateral is sufficiently conservative.

(d) Point 28 is replaced by the following:

"28. By way of derogation from point 26, the competent authorities shall also recognise as eligible providers of unfunded credit protection, other financial institutions authorised and supervised by the competent authorities responsible for the authorisation and supervision of credit institutions and subject to prudential requirements equivalent to those applied to credit institutions. The competent authorities shall publish the list of those other eligible protection providers together with a description of the applicable prudential requirements."

Support

22. In Annex VIII, Part 2, Point 9(a)(ii) is replaced by the following:

"(ii) Credit institutions must take all steps necessary to fulfil local requirements in respect of the enforceability of security interest. There shall be a framework which allows the lender to have a first priority claim over the collateral subject to national discretion to allow such claims to be subject to the claims of preferential creditors provided for in legislative or implementing provisions. When this national discretion is exercised by one Member State, other Member States shall allow their credit institutions to treat as a first priority claim a security interest in that Member State, subject to those claims of preferential creditors." Support

23. Annex VIII, Part 3 is amended as follows:
(a) Point 12 is replaced by the following:

"12. As an alternative to using the Supervisory volatility adjustments approach or the Own Estimates volatility adjustments approach in calculating the fully adjusted exposure value (E*) resulting from the application of an eligible master netting agreement covering repurchase transactions, securities or commodities lending or borrowing transactions, and/or other capital market driven transactions other than derivative transactions, credit institutions may, subject to the approval of the competent authorities, be permitted to use an internal models approach (...). Subject to the approval of the competent authorities, credit institutions may also use their internal models for margin lending transactions, if the transactions are covered under a bilateral master netting agreement that meets the requirements set out in Annex III, Part 7."; **Support** on the basis that we understand the amendment to clarify that use of internal models approach is subject to the approval of the relevant competent authorities. **Support** We also cross reference to item 14 (a) and (b) earlier in the document (the alpha factor) as we believe the wording here is probably what is intended in the earlier part of the text.

(b) Point 19 is replaced by the following:

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

(c) Point 43 is replaced by the following:

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

(d) Point 59 is deleted; **Support**

(e) Points 73 to 75 are replaced by the following: **Support**

(24) Annex IX, Part 4 is amended as follows:

(a) Point 30 is replaced by the following:

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

(b) Point 31 is deleted; **Support**

(c) Last paragraph of point 53 is replaced by the following:
"For securitisations involving retail exposures, the competent authorities may permit—the Supervisory Formula Method to be implemented using the simplifications: h=0 and v=0, provided that the institution applies this approach consistently.". Support

25. Point 3 of Annex X, Part 2 is replaced by the following:

"3. Competent authorities may authorise a credit institution to calculate its capital requirement for operational risk using an alternative standardised approach, as set out in points 5 to 11. For certain business lines, credit institutions may use an alternative relevant indicator for determining their capital requirement for operational risk as set out in Annex X, Part 2, points 5 to 11 if the relevant competent authorities approve that the conditions there specified are met." Support

26. Point 11 of Annex X, Part 3 is replaced by the following:

"11. Correlations in operational risk losses across individual operational risk estimates shall be recognised only if credit institutions can demonstrate to the satisfaction of the competent authorities that their systems for measuring correlations are sound, implemented with integrity, and take into account the uncertainty surrounding any such correlation estimates, particularly in periods of stress. The credit institution must validate its correlation assumptions using appropriate quantitative and qualitative techniques. The Committee of European Banking Supervisors shall establish guidelines on all supervisory decisions taken by the competent authorities to implement this Directive with a view to ensuring the convergence of supervisory practices." Support on the basis that this change is specific to correlation assumptions in AMA model, rather than a wider statement which would establish CEBS as single European rule maker.

Below are presented the areas in which options and national options will be removed from Directive 2006/48/EC.

1. Article 18 is amended as follows:
   (a) The introductory phrase in paragraph 2 is replaced by the following:
   "2. By way of derogation from paragraph 1, the competent authorities may allow institutions to calculate the capital requirements for their trading book business in accordance with Article 75(a) of Directive 2006/48/EC and points 6, 7, and 9 of Annex II to this Directive, where the size of the trading book business meets the following requirements:" Support
   (b) Paragraph 3 is replaced by the following:
   "3. In order to calculate the proportion that trading-book business bears to total business for the purposes of points (a) and (c) of paragraph 2, institutions may refer either to the size of the combined on- and off-balance-sheet business, to the profit and loss account or to the own funds of the institutions in question, or to a combination of those measures. When the size of on- and off-balance sheet business is assessed, debt instruments shall be valued at their market prices or their principal values, equities at their market prices and derivatives according to the nominal or market values of the instruments underlying them. Long positions and short positions shall be summed regardless of their signs. The Commission shall review the implementation of this provision by 31 December 2011.". Support

2. Article 19 is amended as follows:
Paragraph 2 is replaced by the following:

"2. By way of derogation from points 13 and 14 of Annex I, Member States may in certain circumstances derogate from the specific risk requirement for any bonds falling within points 68 to 70 of Part I of Annex VI to Directive 2006/48/EC as 8% of the risk-weighted exposure amounts or applying a weighting of 8% of the risk weight, as applicable in the same institution's non-trading book, which shall be equal to the specific risk requirement for a qualifying item with the same residual maturity as such bonds and reduced in accordance with the percentages given in point 71 of Part I to Annex VI to that Directive."

Paragraph 3 is replaced by the following:

"3. If, as set out in point 52 of Annex I, a competent authority approves a third country's collective investment undertaking (CIU) as eligible, a competent authority in another Member State may make use of this approval without conducting its own assessment. Competent authorities shall allow credit institutions to use a collective investment undertaking established in a third country provided that the requirements in points (a) to (e) of point 51 of Annex I are met. To this end, the Committee of European Banking Supervisors shall conduct an assessment of the supervisory and regulatory arrangements of the relevant third country."

As we noted above, it is important to note in this context, that while harmonisation is a legitimate goal, this change puts a high priority on CEBS delivering a swift, transparent and effective process so that firms’ businesses are not impeded. Thus we believe it will be important to be very clear on the process that CEBS will utilize in its assessments, including the timings and consultation of the competent authorities.

Article 20 is amended as follows:

(a) The introductory phrase in paragraph 2 is replaced by the following:

"2. By way of derogation from paragraph 1, competent authority may allow investment firms that are not authorised to provide the investment services listed in points 3 and 6 of Section A of Annex I to Directive 2004/39/EC may provide own funds which are always more than or equal to the higher of the following;"

(b) The introductory phrase in paragraph 3 is replaced by the following:

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

Article 24 is amended as follows:

(a) The first paragraph is replaced by the following:

'By way of derogation from Article 2(2), competent authorities may exempt an investment firm may choose not to apply from the consolidated capital requirement established in that Article, provided that all the investment firms in the group are covered by Article 20(2) and the group does not include credit institutions.'

(b) The introductory phrase in the second paragraph is replaced by the following:
"Where the requirements of option in paragraph 1 is used are met,". Support

(c) The introductory phrase in the third paragraph is replaced by the following:
"Where the requirements of option in paragraph 1 is used are met,". Support

5. Article 25 is amended as follows:
(a) The first paragraph is replaced by the following:
"By way of derogation from Article 2(2), competent authorities may exempt an investment firm may choose not to apply from the consolidated capital requirement established in that Article, provided that all the investment firms in the group fall within the investment firms referred to in Article 20(2) and (3), and the group does not include credit institutions."; Support

(b) The introductory phrase in the second paragraph is replaced by the following:
"Where the requirements the option in the first paragraph is used are met,"; Support

(c) The introductory phrase in the third paragraph is replaced by the following:
Where the requirements the option in the first paragraph is used are met.". Support

6. Article 33(3) is deleted. The deletion appears to carry with it the requirement for daily valuation of all positions in the trading book. As the market conditions immediately following the attack on 11 September 2001, this is not always possible. Hence we believe that some flexibility will be required to ensure that the EU is able to respond to a market wide crisis.

7. Annex I is amended as follows:
(a) In point 4, the second paragraph is deleted; We have had insufficient time to analyse the potential impact of this proposal and therefore do not comment

(b) In point 5, the second paragraph is deleted; We have had insufficient time to analyse the potential impact of this proposal and therefore do not comment

(c) In point 5, the third paragraph is replaced by the following: We have had insufficient time to analyse the potential impact of this proposal and therefore do not comment

"Other risks, apart from the delta risk, associated with options shall be safeguarded against. The competent authorities may allow the requirement against a written exchange-traded option to be equal to the margin required by the exchange if they are fully satisfied that it provides an accurate measure of the risk associated with the option and that it is at least equal to the capital requirement against an option that would result from a calculation made using the method set out in the remainder of this Annex or applying the internal models method described in Annex V. The competent authorities may also allow the capital requirement for an OTC option cleared by a clearing house recognised by them to be equal to the margin required by the clearing house if they are fully satisfied that it provides an accurate measure of the risk associated with the option and that it is at least equal to the capital requirement for an OTC option that would result from a calculation made using the method set out in the remainder of this Annex or applying the internal models method described in Annex V. In addition they may allow the requirement on a bought exchange-traded or OTC option to be the same as that for the instrument underlying it, subject to the constraint that the resulting requirement does not exceed the market value of the option. The-
requirement against a written OTC option shall be set in relation to the instrument underlying it.

(d) In point 14, the next to last paragraph is replaced by the following:

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

(e) Point 26 is replaced by the following:

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

(f) Point 52 is replaced by the following:

"52. Third country CIUs shall be eligible if the requirements in points (a) to (e) of point 51 are met, subject to the approval of the institution's competent authority process defined in Article 19.3." Support

8. Annex III is amended as follows:

(a) In point 2.1, the last sentence is replaced by the following:

"The competent authorities shall have the discretion to allow institutions to An institution may use the net present value when calculating the net open position in each currency and in gold provided that the institution applies this approach consistently."; Support

(b) In point 3.1, the first two sentences are replaced by the following:

"The competent authorities may allow Institutions may to provide lower capital requirements against positions in closely correlated currencies than those which would result from applying points 1 and 2 to them. The competent authorities may deem A pair of currencies is deemed to be closely correlated only if the likelihood of a loss — calculated on the basis of daily exchange-rate data for the preceding three or five years — occurring on equal and opposite positions in such currencies over the following 10 working days, which is 4% or less of the value of the matched position in question (valued in terms of the reporting currency) has a probability of at least 99%, when an observation period of three years is used, or 95%, when an observation period of five years is used.". Support

9. Annex IV is amended as follows:

(a) In point 7, the introductory phrase is replaced by the following:

"7. The competent authorities may regard the following positions as positions in the same commodity: For the purposes of calculating a position in a commodity, the following positions shall be treated as positions in the same commodity:"; Support

(b) In point 8, the second and the third paragraphs are deleted; We have had insufficient time to analyse the potential impact of this proposal and therefore do not comment

(c) In point 10, the second paragraph is deleted; We have had insufficient time to analyse the potential impact of this proposal and therefore do not comment
(d) In point 10, the last three paragraphs are deleted; We have had insufficient time to analyse the potential impact of this proposal and therefore do not comment.

(e) In point 14, the introductory phrase is replaced by the following:

"14. Competent authorities may allow positions which are, or are regarded pursuant to point 7 as, positions in the same commodity may be offset and assigned to the appropriate maturity bands on a net basis for the following:"

Support