

# Access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms. Capital Requirements Directive (CRDIV)

2011/0203(COD) - 30/05/2012 - Committee report tabled for plenary, 1st reading/single reading

The Committee on Economic and Monetary Affairs adopted the report drafted by Othmar KARAS (EPP, AT) on the proposal for a directive of the European Parliament and of the Council on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and amending Directive 2002/87/EC of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firm in a financial conglomerate.

It recommends that the European Parliament's position at first reading, under the ordinary legislative procedure, should amend the Commission proposal as follows:

**Definitions:** the text introduces the definition of 'systemic institution' which shall mean an institution which in case of failure or malfunction could lead to systemic risk at global or European or domestic level. In addition, the definition of 'systemic risk' has been included and shall mean a risk of disruption in the financial system with the potential to have serious negative consequences for the financial system and the real economy.

**Designation and powers of the competent authorities:** Member States shall ensure that the competent authorities monitor the activities of institutions, and where applicable, of **financial holding companies** and mixed financial holding companies, so as to assess compliance with the requirements of this Directive.

Member States shall designate one or more resolution authorities for overseeing and approving resolution plans as referenced in this Directive. They shall inform the Commission and EBA thereof, indicating any division of duties.

**Mediation powers of EBA and cooperation within the European System of Financial Supervision (ESFS):** competent authorities, as parties to the ESFS shall: (i) cooperate with trust and full mutual respect, in particular when ensuring the flow of appropriate and reliable information between them and other parties to the ESFS in accordance with the principle of sincere cooperation; (ii) participate in the activities of EBA and, as appropriate, in the colleges of supervisors; (iii) make every effort to comply with those guidelines and recommendations issued by EBA in accordance Regulation (EU) No. 1093/2010.

**General requirements for access to the activity of credit institutions:** Member States or their competent authorities may fully or partially exempt one or more credit institutions situated in the same Member State and which are permanently affiliated to a central body which supervises them and which is established in the same Member State, from the requirements set out in the Directive.

**The right of establishment of credit institutions:** the financial information shall also include the consolidated financial information of the credit institution or, where the credit institution is a subsidiary of a parent institution at EU level, the consolidated financial information of that parent institution.

**Collaboration concerning supervision:** the competent authorities of the Member States concerned shall collaborate closely in order to supervise the activities of institutions operating, in particular through a

branch, in one or more Member States other than that in which their head offices are situated. They shall supply one another as well as EBA with all information concerning the management and ownership of such institutions that is likely to facilitate their supervision and the examination of the conditions for their authorisation, and all information likely to facilitate the monitoring of institutions, in particular with regard to liquidity, solvency, deposit guarantee, the limiting of large exposures, other factors that may influence the systemic risk posed by the institution, administrative and accounting procedures and internal control mechanisms.

EBA shall have the power to carry out on a case by case basis announced or unannounced on-the-spot inspections.

**On-the-spot verification and inspection of branches:** a new Article stipulates that the competent authorities of the host Member State shall have the power to carry out on a case by case basis on-the-spot inspections of the activities carried out by branches of institutions on their territory and require information from a branch about its activities.

**Sanctions:** Member States shall provide that their competent authorities may take appropriate administrative sanctions and measures where the national provisions adopted in the implementation of this Directive have not been complied with, and where the violation of these provisions, apart from certain exceptions, is not subject to national criminal law. Member States shall ensure that the sanctions are applied.

Administrative sanctions may be imposed if an institution has been found liable for a serious infringement of the national provisions adopted pursuant to Directive 2005/60/EC on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing.

Member States shall ensure that competent authorities inform EBA without delay and in detail about all sanctions imposed on institutions or individuals under their supervision. Where a competent authority of a Member State applies an administrative sanction to a legal person it shall notify EBA of that sanction and the circumstances under which it was applied. EBA shall monitor and maintain a list of natural persons to whom a sanction has been applied, for the duration that sanction is applicable. When a competent authority assesses the good repute of persons, they shall check for relevant information relating to sanctions with EBA. EBA shall inform them if those persons are currently recorded on their list. EBA shall cooperate in any development of international lists.

The effective and reliable mechanisms shall include at least: (a) specific procedures for the receipt of reports on breaches and their follow-up; (b) appropriate protection, including full anonymity, for employees; (c) clear rules that prohibit institutions from inquiring the identity of an individual who has reported a breach.

**Procedures and internal control mechanisms:** the amended text states that competent authorities shall ensure that the management body of institutions adopts comprehensive resolution plans (living wills), ensuring an effective resolution of the institution in the case of failure and limiting the negative impact on other institutions and the wider economy.

In the case of systemic Institutions and groups identified in accordance with the Directive, the management body shall develop these comprehensive resolution plans (living wills) at individual and group level within one year after inclusion in EBA's list of systemic institutions. They shall constantly be kept updated.

**Supervision of remuneration policies:** it is stipulated that competent authorities shall collect information on the number, names, titles and job responsibilities of individuals per institution being remunerated EUR 1 million or more per financial year.

Remuneration policy makes a clear distinction between criteria for setting:

- **basic fixed remuneration**, which should primarily reflect relevant professional experience and organisational responsibility as set out in an employee's job description as part of the terms of employment,
- **variable remuneration**, which should reflect performance in excess of that required to fulfil the employee's job description as part of the terms of employment,
- **any other employee benefits** beyond those required by law.

For **variable elements of remunerations**, the text lays down the following issues :

- **guaranteed bonuses** are not consistent with sound risk management or the pay-for-performance principle and shall not be a part of prospective compensation plans;
- guaranteed variable remuneration is **exceptional** and occurs only when hiring new staff and is limited to the first year of employment, provided that the institution has a sound and strong capital base;
- fixed and variable components of total remuneration are appropriately balanced and the fixed component represents a sufficiently high proportion of the total remuneration to allow the operation of a fully flexible policy on variable remuneration components, including the possibility to pay no variable remuneration component;
- institutions shall set the **appropriate ratios** between the fixed and the variable component of the total remuneration where the variable component shall not exceed one time the fixed component of the total remuneration;
- remuneration packages related to compensation or buy out from contracts in previous employment shall not be disproportionate, shall not provide an earlier or greater payout than would have been the case in the previous employment, and must also align with the long term interests of the institution including retention, deferment, performance and claw back arrangements;
- a substantial portion, and in any event at least **60 %**, of the variable remuneration component is deferred over a period which is not less than three to 5 years and is correctly aligned with the nature of the business, its risks and the activities of the member of staff in question. In the case of a variable remuneration component of a particularly high amount, **above EUR 100 000** at least 60 % of the amount shall be deferred.

The Commission shall come forward by the end of 2012 with a legislative proposal setting a fixed workable ratio between the fixed and variable components of the remuneration in the financial sector.

**Treatment of risks:** the management body should devote sufficient time to consideration of risk issues. It shall be actively involved in and ensure that adequate resources are allocated to the management of all material risks addressed in this Directive as well as in the valuation of assets, the use of external ratings and internal models related to those risks. The institution must establish reporting lines to the management body that cover all material risks and risk management policies and changes thereof.

Competent authorities shall ensure that institutions that are significant in terms of size, internal organisation and nature, scope and complexity of their activities establish a risk committee or equivalent body composed of members of the management body. An adequate number of members of the committee shall also be independent.

In order to ensure that credit institutions and investment firms have in place sound remuneration policies, the risk committee, or equivalent body, to assist sound compensation policies and practices, shall demonstrate that incentives provided by the compensation system take into consideration risk, capital, liquidity and the likelihood and timing of earnings. The risk management function shall ensure that **all**

**material risks are identified, measured and properly reported.** The risk management function shall be able to report directly to the management body in its supervisory function when necessary, independent from senior management and to raise concerns and warn this body, where appropriate, in case of specific risk developments that affect or may affect the institution.

**Internal Approaches for calculating own funds requirements:** competent authorities shall ensure that internal ratings used by institutions **do not rely solely or mechanistically on external credit ratings and that these do not prevail over internal assessment.** Competent authorities, in cooperation with EBA, shall analyse and assess the performances of the internal ratings capacities within the institutions.

A new provisions obliges competent authorities shall design an hypothetical portfolio of instruments representing the full range of risks to which institutions are exposed and for which they are permitted to use internal models for calculating own fund requirements.

Credit and counterparty risk: competent authorities shall ensure that the development of relationship based lending, where information gleaned from a continuing business relationship with clients is used to get a better quality of due diligence and risk assessment than is available purely from standardized information and credit scores, will be encouraged.

**Liquidity risk:** competent authorities shall ensure that credit institutions have liquidity risk profiles that are consistent with and not in excess of that required for a well-functioning and robust system. Competent authorities shall monitor developments in, amongst other things, product design and volumes, risk management, funding policies and funding concentrations and take effective action where such developments may lead to individual institution or systemic instability. Competent authorities shall inform EBA about any measures carried out and submit a report at least once a year to EBA on developments in these matters.

Institutions should consider different liquidity risk mitigation tools, including a system of limits and liquidity buffers and long term stable funding in order to be able to withstand a range of **different short, medium and long-term stress events.**

**Governance:** 'management body' shall mean the body or bodies of an institution, appointed in accordance with the national law, which is empowered to set the institution's strategy, objectives and overall direction, and which oversees and monitors management decision-making. This shall include persons who effectively direct the business of the institution.

In particular, the references to management body shall comprise both the managerial and supervisory functions of the body or bodies. Where, according to national law, the managerial and supervisory functions of the management body are assigned to different bodies or different members within one body, the Member State shall make the distinction between the responsible bodies or members of the management body in accordance with its national law, unless otherwise specified by the Directive. For the purpose of this Directive 'managerial function' means setting the institution's strategy, objectives and overall direction and 'supervisory function' means overseeing and monitoring management decision-making.

Moreover, the management body shall ensure the integrity of the accounting and financial reporting systems, including the independent audit, financial and operational control and compliance with the law and relevant standards. It shall also oversee the process of disclosure and communications.

The chairman of the management body of an institution which is responsible for the supervisory function shall not exercise simultaneously the functions of a chief executive officer within the same institution, except in certain circumstances.

**Capital buffer rate:** the buffer rate should be based on the buffer guidance of the ESRB. The buffer guidance by the ESRB should take into account the growth of credit levels and changes to the ratio of credit to GDP in Member States. EBA should specify the common rules for implementation of the countercyclical buffer. The ESRB should also provide guidance on which other variables could potentially be relevant for the setting of the countercyclical buffer rates or which otherwise could be relevant indicators for financial stability in one or more Member States, based on discussions with designated authorities and own analysis.

**Identification of Systemic Institutions:** the text states that competent authorities shall indicate Systemic Institutions within their jurisdiction to EBA. Systemically important financial institutions may also be identified by the ESRB. This identification shall be based on quantitative and qualitative analysis on global, Union or domestic level in particular taking into account certain elements specified in the Directive.

**Requirement to Maintain a Systemic Buffer:** systemic institutions at global or Union level as well as domestic systemic institutions shall be assigned to one of five categories of systemic relevance with regard to their relevance for the European or an individual domestic financial market respectively. In the lowest category, systemic financial institutions shall be required to maintain a supplementary Core-Tier 1 capital buffer of 1.0% of total risk exposure, increasing by 0.5% with each of the following categories.

**Review:** by 31 December 2014, the Commission shall review and report on the application of Articles 103 and 104 and shall submit this report to the European Parliament and the Council, and if appropriate, a legislative proposal.