



EUROPEAN CENTRAL BANK
BANKING SUPERVISION

Feedback statement

Responses to the public consultation
on a draft Guideline and
Recommendation of the European
Central Bank

On the exercise of options and discretions
available in Union law for less significant
institutions

BANKENTOEZICHT

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This document is intended to give an overview of the comments received during the public consultation on a draft Guideline and Recommendation of the European Central Bank (ECB) on the exercise of options and discretions available in Union law for less significant institutions (LSIs), and provide an assessment of those comments. It also explains the amendments made to the draft Guideline and Recommendation as a result of the public consultation. It must be underscored that this document does not provide an interpretation of provisions of European Union (EU) law, given that only the Court of Justice of the European Union can provide a legally binding interpretation of those provisions.

1 Overview and analysis of responses

On 3 November 2016 the European Central Bank launched a public consultation on a draft Guideline and Recommendation on the exercise of options and discretions (O&Ds) available in Union law for less significant institutions (LSIs). The consultation encompassed O&Ds in Regulation (EU) No 575/2013 (CRR)¹, Directive 2013/36/EU (CRD IV)² and Commission Delegated Regulation (EU) 2015/61³. The public consultation ended on 5 January 2017. In addition to soliciting written comments, the ECB also gave industry participants and interested parties the opportunity to provide additional input at a public hearing with senior representatives of the ECB. This event was held in Frankfurt am Main on 17 November 2016. While the comments provided during the public hearing are not reflected in the figures of the table below, they have nonetheless been taken into account. The ECB has given due consideration to all of the comments received during the consultation period.

This feedback statement presents an overall assessment of the comments received in the public consultation and aims to address the most relevant issues raised in them. Amendments to the draft Guideline and the draft Recommendation have been made as a result of the comments.

In total, ECB Banking Supervision received seven responses. Contributions were submitted by one financial institution and several market and banking associations from both euro area and non-euro area Member States, showing a broad participation by the relevant stakeholders. Table 1 provides a breakdown of the responses to the consultation by category of respondent.

Table 1
Responses to the public consultation

Breakdown of the responses by category of respondent		
Category	Number of respondents	Percentage
Credit and financial institutions	1	14%
Market and banking associations	6	86%
Total contributions	7	100%

A complete draft proposal for the adoption of a Guideline and Recommendation was submitted by the Supervisory Board to the Governing Council of the ECB on 28

¹ Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1).

² Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338).

³ Commission Delegated Regulation (EU) 2015/61 of 10 October 2014 to supplement Regulation (EU) No 575/2013 of the European Parliament and the Council with regard to liquidity coverage requirement for credit institutions (OJ L 11, 17.1.2015, p. 1).

March 2017. The Guideline and Recommendation were published on the Banking Supervision website on 13 April 2017, together with this feedback statement. The Guideline and the Recommendation were published in the Official Journal of the European Union on the same day.

2 Explanation of the proposal and policy rationale

In 2000 seven banking directives regarding banking prudential requirements were consolidated in a single directive (2000/12/EC)⁴. This directive was recast in 2006 as the Capital Requirements Directives (CRD I package, now repealed) to introduce the Basel II framework in the European Union (EU). It was further enhanced in 2009 (CRD II), 2010 (CRD III) and, most recently, in 2013 with Directive 2013/36/EU (Capital Requirements Directive, known as CRD IV) and Regulation (EU) No 575/2013 (Capital Requirements Regulation, known as CRR) in order to adopt the new Basel III standards. One purpose of the CRD IV package (i.e. CRD IV and CRR) was to further harmonise the options and discretions (O&Ds) available to competent authorities and Member States as inherited from the previous framework. However, the CRD IV package, as well as Commission Delegated Regulation (EU) 2015/61 on the Liquidity Coverage Ratio, still contains a number of O&Ds, many of which are reserved for competent authorities. Some of these should be applied in a general manner while others should be applied following a case-by-case assessment of the specific situation and characteristics of individual banks.

Inconsistent application of O&Ds in participating Member States could potentially impact the overall robustness of the supervisory framework and the comparability of prudential requirements across credit institutions. This would make it difficult for market participants and the general public to gauge the overall capital adequacy and regulatory compliance of credit institutions. The high number of such provisions also adds a layer of regulatory complexity and further increases compliance costs, while leaving ample room for regulatory arbitrage. Furthermore, while some of these differences will gradually diminish over the coming years as transitional arrangements are phased out, a large number of O&Ds are of a permanent nature, leaving considerable divergences in place in the absence of further steps towards harmonisation.

In line with its prudential supervisory mandate, applying robust prudential requirements wherever possible has been a guiding principle of the ECB's work on O&Ds. In addition, the ECB has always taken due consideration of the relevant international standards and, in particular, those emanating from the Basel Committee on Banking Supervision (BCBS) and the Guidelines and Recommendations issued by the European Banking Authority (EBA).

The overarching goal of this initiative is to foster financial integration and ensure the application of high supervisory standards, according to the ECB's mandate within the

⁴ Directive 2000/12/EC of the European Parliament and of the Council of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions (OJ L 126, 26.5.2000, p. 1)

framework of the SSM Regulation⁵ and following the objectives of the Banking Union. An appropriately harmonised treatment of O&Ds will enable ECB Banking Supervision to supervise banks more efficiently and from a truly single perspective. Ultimately, unified European supervision can also contribute to safer and sounder banks that are also better able to support a sustainable economic recovery.

For the purposes of supervising significant institutions (SIs), the ECB has exercised the O&Ds through two separate instruments: a Regulation for O&Ds of general application⁶ and a Guide explaining the policy stance on case-by-case O&Ds. The ECB Guide (first version) became operational, as a legally non-binding instrument, from its date of publication (24 March 2016). The ECB Regulation on the exercise of options and discretions entered into force on 1 October 2016. In a second and final phase of the project the ECB dealt with eight additional O&Ds. The draft Addendum to the ECB Guide was published for consultation in May 2016 and finalised, approved and published in August 2016.

The formulation of a policy for O&Ds under the SSM requires a policy stance to be developed for O&Ds (i) with regard to SIs for which the ECB is directly competent and (ii) with regard to LSIs, as part of the ECB's task of ensuring the effective and consistent functioning of the SSM, fostering consistency of supervisory outcomes and applying high quality standards, also taking into account the principle of proportionality. Based on the ECB Regulation and Guide, ECB Banking Supervision assessed whether each O&D should be exercised in a similar manner for SIs and LSIs to ensure the consistent application of high supervisory standards and the effective and consistent functioning of the system, or whether a different approach would be deemed to be appropriate. This assessment was guided by the principle that the same prudential rules should apply for the same risk exposure (e.g. triggered by business model and risk level).

The exercise of O&Ds with respect to LSIs has been analysed with a particular view to the principle of proportionality, i.e. to what extent a different policy recommendation may be warranted for the exercise of specific options. A careful analysis of the prudential issues underlying each O&D and its relevance for LSI supervision was conducted before the policy guidance was adopted.

⁵ Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63).

⁶ Regulation (EU) 2016/445 of the European Central Bank of 14 March 2016 on the exercise of options and discretions available in Union law (ECB/2016/4) (OJ L 78, 24.3.2016, p. 60).

3 General Comments

3.1 The scope of application and the level playing field

While generally supporting the objectives pursued with the adoption of the Guideline and Recommendation, i.e. the harmonisation of supervisory rules in the framework of the SSM, two respondents wanted to underscore the particularities of credit institutions with a specific business model, such as guarantee institutions and development banks. Institutions that promote access to finance and support economic growth in Europe should not be affected by the heavier bureaucratic burden and higher costs entailed by additional reporting requirements. Most of these institutions are exempted from International Accounting Standards and instead apply national laws to facilitate the running of their activities. When harmonising supervisory rules for banks supervised by national competent authorities (NCAs), guarantee institutions should ideally be exempted as they need a tailored national supervisory framework.

The objective of the harmonised application of O&Ds is to ensure that the prudential rules are applied consistently by all credit institutions in the euro area. It is considered to be neither useful nor necessary to exempt categories of credit institutions from the application of the harmonised rules.

If there are specificities in particular cases, the nature of the instruments allows for supervisory flexibility – in particular with regard to LSIs. This supervisory flexibility, which is aligned with the intention of the legislator not to exclude these institutions from prudential supervision, should be sufficient to address the concerns expressed.

Furthermore, it should be noted that the O&D policies do not introduce additional reporting requirements for all institutions. It is clear that even in the case of SIs there is no obligation to use International Accounting Standards for prudential reporting purposes, given that Article 24(2) of the CRR has not been exercised in a generally applicable manner.

One respondent submits that although the Guideline and Recommendation are addressed only to competent authorities, the provisions have created uncertainty for credit institutions regarding whether they should (a) apply national implementing rules or (b) directly apply the ECB Guideline and Recommendation addressed to NCAs.

As also indicated in the Explanatory Memorandum (pp.6-7), both the Guideline and the Recommendation are addressed only to the NCAs. The main difference between the two legal instruments is that the Guideline is legally binding for NCAs, while the Recommendation is not a legally binding instrument. Hence, NCAs should apply both legal instruments in accordance with their legal status.

3.2 Format of the legal instruments

One respondent submits that in many respects the proposed Guideline and Recommendation refer directly to the rules and the underlying framework adopted by the ECB for SIs. As such, any change related to the rules for SIs will automatically also apply to LSIs unless, at the same time, a dedicated treatment is specified or amendments/exceptions are made in the direct references to the O&D regulatory package for SIs. Furthermore, according to the respondent in question, this regulatory technique (direct reference to the package for SIs) will multiply the relevant sources for the application of the regulatory requirements, making it more complex for LSIs to ascertain the rules applicable to them.

As far as the Guideline is concerned, the ECB acknowledges that the references in the proposed legal instrument to the ECB Regulation on O&Ds could also automatically incorporate in the framework for LSIs any future changes in that Regulation that would apply to SIs (unless the Guideline is adjusted for LSIs). To address this comment, the ECB has redrafted the provisions in the Guideline. Instead of using direct references to the relevant articles and annexes in the ECB Regulation on O&Ds, the Guideline now incorporates the text of these articles in the Regulation and its annexes (with tailored adjustments, e.g. where applicable replacing “European Central Bank” with “national competent authority”).

Turning to the Recommendation, this is a non-legally binding instrument. Any reference to the framework for SIs will not, therefore, automatically also apply to LSIs. In this regard, the ECB does not think it necessary to incorporate all the relevant text from the ECB Guide on options and discretions available in Union Law (consolidated version – November 2016) but considers that the reference to the relevant paragraphs is sufficient. Clearly, when the policy for LSIs differs from the policy for SIs for specific O&Ds, the exercise of those O&Ds has been directly addressed in the Recommendation (see Part Two).

4 Comments on the draft Guideline

4.1 Exemptions from the limits to large exposures (Article 6)

With regard to the options to exempt certain exposures from the large exposure limits one respondent submits that it is not clear for the public whether, in cases where the option for Member States in Article 493(3) of the CRR has been exercised, this always overrules the symmetric option for competent authorities in Article 400(2) of the CRR.

The ECB would like to reiterate that it is clear from the wording of Article 400(2) and Article 493(3) of the CRR that the exercise of the option for Member States always overrules, and pre-empts, the exercise of the symmetric option for competent authorities.

Only where the option has not been exercised by the Member States can the competent authorities exercise the options in Article 400(2) of the CRR. This is also acknowledged by Article 9(7) of the ECB Regulation on O&Ds.

It is worth recalling that pursuant to Commission Implementing Regulation (EU) No 2014/650⁷ the way in which the O&Ds included in Annex 2, part 1, have been exercised must be disclosed and that the options referred to in Article 400(2) and Article 493(3) of the CRR are included in this Annex. The EBA is providing updated disclosures of the exercise of these options for the general public also.

In any case, the ECB is well aware that many Member States have exercised the options relating to large exposure limits and regularly applies the relevant legislation/regulation to SIs in accordance with the applicable national frameworks. For NCAs it will be even simpler to verify whether the Member States have exercised such options and apply the relevant framework to LSIs.

Several respondents held the view that covered bonds should be fully exempted from the limits to large exposures. One respondent emphasised that since covered bonds also facilitate compliance with the liquidity coverage ratio requirements (Article 10(1)(f) of Commission Delegated Regulation (EU) 2015/61), the possibility of a full exemption should be maintained.

The policy decision to allow only a partial exemption for covered bonds from the limits to large exposures was taken to align the European framework with the BCBS Supervisory Framework for Measuring and Controlling Large Exposures. Under the BCBS Framework, exposures to covered bonds are, but only under certain conditions, assigned a value of no less than 20% of the nominal value of the exposure holding. A partial exemption of 80% of the exposure value should therefore

⁷ Commission Implementing Regulation (EU) No 650/2014 of 4 June 2014 laying down implementing technical standards with regard to the format, structure, contents list and annual publication date of the information to be disclosed by competent authorities in accordance with Directive 2013/36/EU of the European Parliament and of the Council (OJ L 185, 25.6.2014, p. 1)

be applied. There is no sufficient prudential justification to deviate from this policy for LSIs and create (further) divergence within the SSM framework as regards the ECB treatment.

In addition, Article 400(2) of the CRR provides the possibility for the supervisor to fully exempt the exposures in question (hence the supervisory discretion) but does not envisage any obligation to do so.

4.2 Applicable percentages for deduction from Common Equity Tier 1 of significant investments in financial sector entities and deferred tax assets that rely on future profitability (Article 9)

Two respondents opposed the shortening of the phase-out period for the non-deduction of deferred tax assets (DTAs) that rely on future profitability, as a general shortening of the transitional periods would not be in line with the legislative approach and could overlook specific Member State situations.

The ECB is of the view that the prudential benefits deriving from the quality of capital outweigh any potential negative impacts. To ensure high supervisory standards and consistent treatment of DTAs under the SSM, all institutions should apply the same policy. There is no justification for a less conservative approach for LSIs.

To avoid undesired effects, banks that are subject to restructuring plans are exempted from the application of the shortened transitional period.

5 Comments on the draft Recommendation

5.1 Liquidity waivers at cross-border level (Part Two, Section II.1.)

One respondent submits that, although the exercise of this option is included in Part Two of the draft Recommendation, where a specific exercise for LSIs is defined, Part Two, Section II.1. then refers back to the ECB Guide on options and discretions available in Union Law. Where cross-border liquidity waivers are concerned, it does not seem to provide for a different regime for LSIs.

In order to clarify this aspect, the ECB wishes to underscore that Section II.1. does not include, for instance, criterion (b) of Article 8(3) of the CRR in the criteria that should be assessed by NCAs in accordance with the specifications laid down in the ECB Guide on options and discretions available in Union Law. This policy specification constitutes a significant aspect of the ECB policy for cross-border liquidity waivers and applies only to significant sub-entities and groups. This clearly represents a significant difference between the policy for LSIs and the policy for SIs. The other specifications in the ECB Guide on O&Ds for the assessment of cross-border liquidity waivers, relating to paragraphs (a), (d) and (f) of Article 8(3) of the CRR, are instead equally relevant for LSIs. It was considered appropriate, from a policy perspective, for the NCAs to apply the same specifications when assessing applications from LSIs for cross-border liquidity waivers.

To provide more clarity on the application of this option the wording of Section II.1. of the Recommendation has been slightly amended.

5.2 Exposures in the form of covered bonds (Part Two, Section III.1.)

Several respondents raised concerns regarding the policy on the application of Article 129(1) of the CRR as the proposed treatment for LSIs may be more restrictive than the one for SIs. NCAs are already obliged to consult the EBA on the decision to partly waive the application of Article 129(1)(c) of the CRR and allow credit quality step 2 for up to 10% of the total exposure of the nominal amount of outstanding covered bonds of the issuing institution. It should be clarified that the NCA is responsible for exercising this option and that the ECB only needs to be consulted. One respondent went even further and considered the consultation as an unnecessary step-up in the prerequisites for NCAs to apply this waiver.

The approach envisaged in the ECB Recommendation does not limit the NCAs in their decision to partly waive the application of Article 129(1)(c) of the CRR. The Recommendation clearly states that NCAs will take this decision and that the ECB

only needs to be consulted. The aim of the recommendation is to coordinate the process on policy decisions within the SSM as regards the exercise of this discretion, by striving to ensure that exposures in the form of the same covered bond held by different institutions are treated in the same prudential way.

5.3 Deduction of holdings in institutions that fall within institutional protection schemes (Part Two, Section IV.1.)

One respondent welcomed the clarification that an institutional protection scheme (IPS) can submit a request on behalf of all LSIs affiliated to it. However, this seems to suggest that SIs would have to submit individual applications for all the group entities, which would lead to administrative duplications and overlaps.

The procedural aspects related to applications by SIs are not addressed under this consultation.

5.4 Deduction of insurance holdings (Annex – Own funds)

One respondent submits that the reference to the exercise of this option in Chapter 2, paragraph 4 of the ECB Guide on options and discretions available in Union Law also includes a reference to paragraph (i), namely that only for applications granted before 4 November 2014 can credit institutions continue not to deduct holdings in insurance undertakings within a conglomerate.

The references to the policies for SIs as set out in the ECB Guide on options and discretions available in Union Law should only be applied to LSIs if they are relevant.

Clearly, the date of 4 November 2014 was mentioned in paragraph (i) because that was the date of the formal transfer of supervisory powers to the ECB under the SSM and is particularly relevant for SIs. That specific date should not therefore be considered relevant for applications granted to LSIs that remained under the direct supervision of the NCAs also after 4 November 2014.

As a general rule, exemptions and waivers already granted to credit institutions by NCAs (in this case the possibility not to deduct from own funds holdings in insurance undertakings within a conglomerate) remain valid. Hence, there is no specific issue of infringement of the principle of legitimate expectations. In any case, appropriate disclosure requirements should be met.

5.5 Intragroup liquidity outflows (Annex – Liquidity)

Several respondents expressed the view that LSIs should not be burdened with daily monitoring of counterparty liquidity positions, referring to the following paragraph in the O&D Guide: “In order to assess whether the liquidity risk profile of the liquidity receiver is adequately taken into account in the liquidity risk management of the

liquidity provider, the ECB expects to be shown that the liquidity-providing entity monitors on a regular basis the liquidity position of the counterparty, including its daily liquidity position.” In particular, according to this respondent, LSIs that have entered into an IPS should not be required to monitor the liquidity position of the central institution on a daily basis, also considering that this would not be feasible in the light of operational arrangements and IT solutions.

It should be noted that this part of the O&D Guide is only applicable when the institutions are established in different Member States. One of the conditions that must be met to be recognised as an IPS in accordance with Article 113(7) of the CRR is that the IPS members must be established in the same Member State. This requirement should not therefore apply to IPS member institutions.

More generally, the wording under Section II, Chapter 6, paragraph 11(iv) of the O&D Guide for SIs requires regular access to daily liquidity positions. Alternatively, institutions are expected to demonstrate how the appropriate information on the liquidity positions of the entities involved is made available to the parties on a regular basis.

5.6 Diversification of holdings of liquid assets (Annex – Liquidity)

Two respondents submitted that the restrictions for the purpose of diversifying holdings of liquid assets, in particular those applying to covered bonds if on aggregate they represent more than 60% of the total amount of liquid assets net of applicable haircuts, should not be applied to LSIs. This requirement would be particularly burdensome for LSIs. Imposing strict diversification requirements and hard limits would increase the costs of liquidity coverage ratio (LCR) compliance and the effort required to identify appropriate securities. It would not provide any benefit in terms of the quality of the pool of assets used to comply with the LCR and the overall liquidity position of the institution.

A particular focus on covered bonds is justified, as they might be used to cover 70% of the overall liquidity buffer (see Article 17(1) of Commission Delegated Regulation (EU) 2015/61). The relevance of covered bonds in the European funding markets has already been taken into account in this Regulation (according to the BCBS standards, covered bonds are only treated as level 2A assets). In order to avoid excessive concentration risk the diversification requirement must be taken into account.

As defined under Section II, Chapter 6, paragraph 5 of the O&D Guide, the ECB intends to impose restrictions or requirements on credit institutions for the purpose of diversifying their holdings of liquid assets, as specified in Article 8(1) of Commission Delegated Regulation (EU) 2015/61, on a case-by-case basis. In this context, the ECB will assess concentration thresholds by asset class in each individual case and will focus in particular on covered bonds if on aggregate they represent more than 60% of the total amount of liquid assets net of applicable haircuts.

Therefore, this threshold should not be understood as a hard limit, but as a threshold that requires supervisors to assess carefully whether there is any concentration risk that should be limited. In this assessment, supervisors may, for instance, also take into consideration the issuers of the covered bonds.

5.7 Higher outflow rates (Annex – Liquidity)

Two respondents argued that LSIs do not usually have market-making profiles or hold products that require aggressive marketing of deposit refinancing. For this reason, LSIs should have the certainty that only the legally specified limits set out in Article 25(3) of Commission Delegated Regulation (EU) 2015/61 are relevant for the internal simulation of the LCR. A different determination should remain in the hands of the competent authority on a case-by-case basis

The ECB is of the view that NCAs should have the discretion to apply a higher outflow rate on a case-by-case basis, as envisaged in Commission Delegated Regulation (EU) 2015/61. Generally, the conditions under Section II, Chapter 6, paragraph 9 of the O&D Guide include a non-exhaustive list of cases which would justify the application of higher outflow rates. Apart from the fact that there may be other reasons to apply a higher outflow rate on a case-by-case basis, the conditions do not necessarily have to be met simultaneously. The list simply provides examples that help supervisors to identify cases which justify higher outflow rates.

5.8 Additional collateral outflows from downgrade triggers (Annex – Liquidity)

Two respondents asked the ECB to adjust the materiality threshold of 1% of the gross outflows of a given institution to bring it into line with established practices in LSIs. In the absence of a definition of materiality of outflows in Commission Delegated Regulation (EU) 2015/61, institutions often rely on the definitions set out in Article 423(3) of the CRR or in the final draft of the EBA's Regulatory Technical Standards (RTS) 2014/05.

It should be noted that the EBA's RTS (which have not been endorsed by the European Commission) define a threshold for the materiality of derivative transactions. These are considered as material if the notional amount of the derivatives exceeds 10% of net outflows. In the ECB's view, this definition is not appropriate for use in relation to Article 30(2) of Commission Delegated Regulation (EU) 2015/61, which refers to the materiality of potential outflows.

The threshold of 1% was selected to ensure that the removal of the non-material part of these outflows would not significantly change the LCR.

However, as envisaged under Section II, Chapter 6, paragraph 12 of the O&D Guide, the ECB will reconsider the appropriateness of this threshold (1% of gross liquidity

outflows) on the basis of the data available from the EU harmonised reporting framework in line with Commission Delegated Regulation (EU) 2015/61.

5.9 Additional non-executive directorships (Annex – Governance arrangements and prudential supervision)

One respondent asked for clarification that the limit on mandates stated in Article 91(3) of CRD IV applies only to SIs and that there is no limit on mandates envisaged for LSIs. In the case of LSIs, the basis for granting, or not granting, an additional mandate may only be a limit set under national law.

This option is applicable to SIs in the meaning of CRD IV, i.e. institutions that are significant in terms of their size, internal organisation and the nature, scope and complexity of their activities. The definition of CRD IV significance does not correspond to the significance criteria as defined in the SSM Regulation. LSIs can also be classified as CRD IV-significant. In any case, national law transposing CRD IV applies.

6 Other changes introduced

6.1 Exemptions from the limits to large exposures (Article 6)

Due to a need for further consideration of the ECB policy on the exemption of intragroup exposures from the large exposure limits in accordance with Article 400(2)(c) of the CRR, the ECB has decided to exclude this option from the scope of the Guideline for the time being.

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