EUROPEAN CENTRAL BANK

BANKING SUPERVISION

Public consultation

on a draft Regulation and Guide of the European Central Bank on the exercise of options and discretions available in Union law

Explanatory memorandum

BANKENTOEZICHT BANKTILLSYN BANKU UZRAUDZĪBA BANKŲ PRIEŽIŪRA NADZÓR BANKOWY VIGILANZA BANCARIA BANKFELÜGYELET BANKING SUPERVISION SUPERVISION BANCAIRE BANČNI NADZOR MAOIRSEACHT AR BHAINCÉIREACHT NADZOR BANAKA BANKING SUPERVISION PANGANDUSJÄRELEVALVE SUPERVISÃO BANCÁRIA BANKOVNÍ DOHLED БАНКОВ НАДЗОР BANKTILSYN BANKENAUFSICHT ΤΡΑΠΕΖΙΚΗ ΕΠΟΠΤΕΙΑ PANKKIVALVONTA SUPRAVEGHERE BANCARĂ BANKOVÝ DOHĽAD SUPERVIŻJONI BANKARJA SUPERVISIÓN BANCARIA BANKING SUPERVISION BANKENAUFSICHT SUPERVISÃO BANCÁRIA

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1 Context of the proposed act

1.1 Reasons for and objectives of the proposal

In 2012, the developments in and worsening of the euro area sovereign crisis and the aim of breaking the adverse linkage between public finances and banking systems at the national level led to the decision, at the euro area summit of June, to develop a road map for the achievement of a genuine economic and monetary union.

Within this roadmap it was also decided to establish a Single Supervisory Mechanism.

In accordance with Article 127(6) of the Treaty on the Functioning of the European Union, the Single Supervisory Mechanism Regulation of 15 October 2013 (Council Regulation (EU) 1024/2013, hereinafter SSM Regulation) confers supervisory tasks on the ECB. The aim is to contribute to the safety and soundness of credit institutions and the stability of the financial system within the Union and each Member State, with full regard for the unity and integrity of the internal market. This mandate calls on the ECB to work to establish a level playing field for the banks under its supervision.

Regulatory harmonisation in the field of prudential regulation started in 2000, when seven banking directives were replaced by a single directive. This directive was recast in 2006 (CRD I) to introduce the Basel II framework in the EU. It was further enhanced in 2009 (CRD II), 2010 (CRD III) and finally 2013 (CRDIV/CRR) in order to, among other purposes, adopt the new Basel III standards. One purpose of the Capital Requirements Regulation (EU) 575/2013 and the Capital Requirements Directive 2013/36/EU ("CRD IV package") was to address the issue of options and discretions inherited from the previous frameworks. However, the CRD IV package, as well as the Commission Delegated Regulation (EU) 2015/61 of 10 October 2014 on the Liquidity Coverage Ratio ("LCR Delegated Act") still contain a number of options and discretions (O&Ds)[1]. Some of these are applied in a general manner and some are applied following a case-by-case assessment of the particular status and characteristics of a specific bank. Differentiated application of O&Ds of both these categories within the SSM, where not appropriately justified, may have material effects on the overall level of prudence of the framework and on the comparability of capital ratios that make it difficult for markets and the public to gauge the capital strength of the banks. The high number of such provisions of differentiated application also adds a layer of complexity and costs which is particularly burdensome for firms operating across borders, and leaves room for regulatory

[1] "Option" refers to a situation in which competent authorities or Member States are given a choice on how to comply with a given provision selecting from a range of alternatives set forth in Community legislation and "national discretion" refers to a situation in which competent authorities or Member States are given a choice whether to apply - or not to apply - a given provision in Community legislation (See European Banking Authority's (EBA) final draft Implementing Technical Standard on Supervisory Disclosure).

arbitrage. Finally, the fact that significant divergences effectively remain in the way EU laws are applied at the national level can negatively affect the SSM's ability to supervise banks efficiently and from a truly single perspective.

Since becoming the competent authority for the significant institutions within the euro area on 4 November 2014, the ECB has had the power to determine the most appropriate way to exercise the supervisory O&Ds for the institutions under its direct supervision. Recital 2 of the SSM Regulation states that it is essential to intensify the integration of banking supervision in order to bolster the Union, restore financial stability and lay the basis for economic recovery and Article 1 of the SSM Regulation lays out the unity and integrity of the internal market as one of the objectives of the conferral of powers to the ECB. In addition, the ECB has the mandate to ensure the consistent functioning of the SSM[2]. Within this framework, the ECB has recently started a rigorous assessment to determine how to exercise the O&Ds in the best interests of the Banking Union.

Following this assessment, the O&Ds are divided mainly according to their modality of application as described above (i.e. general or case by case) and exercised via two distinct instruments[3]. The first instrument, the Regulation under consultation, harmonises the exercise of 35 general options and discretions contained in the CRD IV package and the LCR Delegated Act. The ECB has also adopted a specific approach regarding 82 further options and discretions, including those O&Ds applicable on a case-by-case basis. This approach is described in the second instrument, a Guide, published for consultation along with the Regulation.

1.1.1 Problems addressed

Number and nature of O&Ds: Focusing on the provisions of the CRR/CRD IV and the LCR Delegated Act where a clear and explicit discretionary mandate is given to Member States or supervisors (competent authorities), the ECB has identified over 150 O&Ds, ranging from the progressive phase-in of new standards and definitions to more permanent exemptions from the general rules. These O&Ds allow Member States or supervisors either to choose from alternative treatments (options), or simply not to apply certain provisions (discretions).[4]

Member State and Competent Authorities O&Ds: The principal distinction which needs to be made is between those O&Ds granted to Member States on the one hand and those granted to supervisors on the other. In addition, a very limited number of provisions grant power alternatively to the Member State or the supervisor. The ECB's current work addresses the O&Ds where power is granted to the supervisor, as they fall under the ECB's competence with regard to significant institutions. This category of supervisory O&Ds is composed of 122 O&Ds in the

[2] See Article 6 of the SSM Regulation

[3] Part 4 of this Memorandum elaborates on the details on this division and the selection of appropriate instruments to deal with each category.

[4] Other provisions that allow *de facto* for some flexibility in the exercise of supervisory judgement, but where the discretionary mandate is less clear and explicit, were not included in this exercise. These provisions will be addressed at a later stage.

CRR/CRDIV Level 1 texts, including some O&Ds laid down in the LCR Delegated Act[5]. The reason for extending the exercise beyond the focus of CRR/CRD IV is that the LCR Delegated Act entered into force in October 2015. It is therefore important to have a single approach regarding the LCR within the SSM.

General and case-by-case O&Ds: As introduced above, a distinction can be made between general and case-by-case O&Ds among the O&Ds granted to the supervisors. For general O&Ds, the decision of the supervisor applies to all banks, whereas for case-by-case O&Ds, supervisory decisions are bank-specific. The O&Ds of a general nature are very varied. In some cases, they concern provisions allowing for a smoother transition towards the new definition of own funds for banks. There are also general O&Ds related to defining treatments in the capital requirements, large exposures and liquidity framework.

The ECB has designed a Guide containing harmonised policies regarding the exercise of case-by-case O&Ds. Typical instances of case-by-case O&Ds can be found in the various waivers and derogations from the general rule. Many of these provisions require the supervisor's assessment of specific requests made by institutions. Within the framework of this assessment, the supervisor checks whether conditions listed in the legislation are fulfilled. These conditions can be further specified, either through Binding Technical Standards and Guidelines drafted by the European Banking Authority (EBA) and adopted by the European Commission – if available or through internal guidance to the Joint Supervisory Teams (JSTs) of the ECB. The ECB then needs to take individual decisions on whether to grant such a waiver or derogation for each applicant bank, while ensuring that these decisions are in line with the principles of prudence and equal treatment.

Harmonisation of options and discretions in the LCR Delegated Act: The LCR Delegated Act (LCR DA) has been applicable to EU credit institutions since 1 October 2015, and provides for the first time an EU-wide legal framework for banks' liquidity requirements. This gives the ECB the opportunity to promote rigorous harmonisation from the initial stage of the process, while also responding to the expectation of a significant number of NCAs which consider that the ECB should take the lead in forming the policy stance on these options. The policy decisions that the ECB will make can also foster a higher level of harmonization, as they can represent a benchmark in forming the policy stance on these options by other NCAs.

1.1.2 Objectives of the proposal

The overarching goal of this initiative is to foster financial integration and set high supervisory standards, according to the ECB's mandate within the framework of the SSM Regulation and following the objectives of the banking union. An appropriately harmonized treatment of O&Ds will enable the SSM to supervise banks more efficiently and from a truly single perspective. Ultimately, single European

[5] Among those 122 O&Ds, 5 O&Ds were not transposed in the Regulation or the Guide, given that they did not require a divergent policy decision from what already in place in national or European legislation.

supervision can also contribute to banks being safer, sounder, and more able to support a sustainable economic recovery.

In its effort to achieve these objectives, the ECB complies with relevant Union law and respects in particular the tasks entrusted to the EBA of developing draft technical standards and guidelines and recommendations ensuring supervisory convergence and consistency of supervisory outcomes within the Union.[6]

1.2 Context: the O&D Project

In its meeting of 24 April 2015, the Eurogroup supported a concerted work effort on O&Ds by the ECB "in order to move rapidly to a more level playing field within the Banking Union". It was concluded that "this issue would merit being discussed further in the relevant committees (EFC/EWG)".

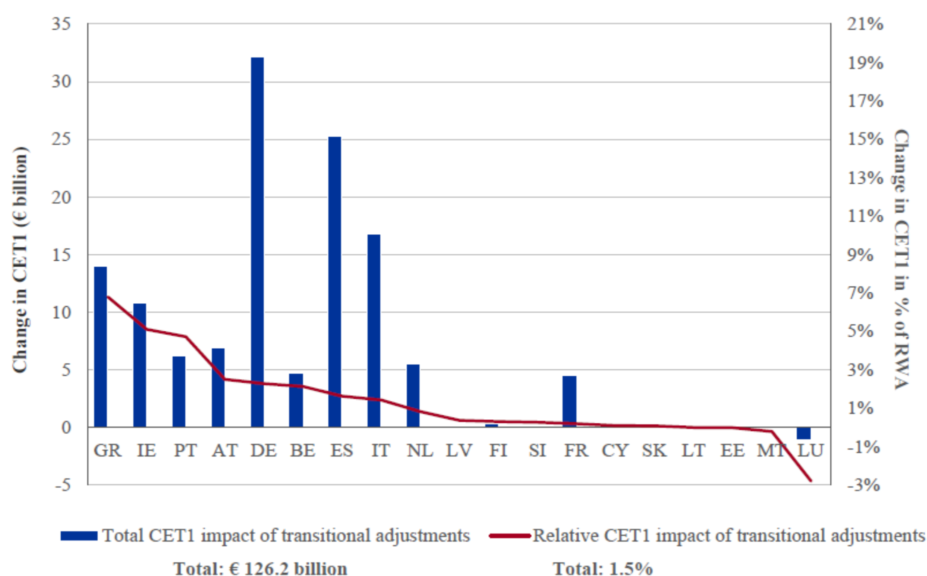
The ECB work on the O&Ds was initiated during the preparatory phase of the SSM. The relevance of this work was confirmed by the Comprehensive Assessment (CA). As the CA showed, there were very significant differences in the way the O&Ds were exercised across the euro area, in particular as regards the use of the transitional provisions of CRR/CRD IV for the computation of CET1 capital, measured at the reference date of 1 January 2014, with a material impact on the level playing field (see Figure 1 below)[7]. 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 and therefore considerable differences would remain if no steps towards harmonisation were taken. All in all, the existence of differences in the way O&Ds are exercised significantly hampers the level playing field within the Banking Union, making this issue a matter of priority for the SSM.

[6] As envisaged by Recital 32 of the SSM Regulation, the ECB should not replace the exercise of those tasks by the EBA.

[7] The impact of the transitional adjustments on available CET1 capital, calculated by comparing banks' CET1 capital as per the transitional arrangements at 1 January 2014 with the amount of CET1 they would hold if a fully-loaded CET1 definition were applied, amounted to €126.2 billion. The magnitude of the transitional adjustments, however, is driven both by the choices made by NCAs at national level and by the balance sheet composition at bank level.

Figure 1

Impact of transitional arrangements on CET1 ratios in the SSM



Note: Based on transitional arrangements projected by the banks included in the EBA disclosure template; Calculated based on a fully implemented CRR/CRD IV definition of Common Equity Tier 1 capital including 60% of unrealised gains/losses from Sovereign Exposure in AFS portfolio.

Source: Comprehensive Assessment Report

In line with the SSM mandate, prudence has been the guiding principle of the ECB's work on O&Ds. In addition, financial integration should be furthered through equal treatment, thereby ensuring a level playing field, where for the same business and the same risks, the same rules would apply.

The ECB has also given special consideration to the international standards and in particular to the work of the Basel Committee.

Lastly, the ECB has taken into account legitimate expectations created by previous decisions by national authorities on the affected banks.

Following these principles, the ECB has conducted a careful analysis of the current national implementation and practices. This analysis fed into the work of a High Level Group (HLG) on O&Ds in which the ECB as well as the NCAs were represented. The HLG delivered an initial policy package to the Supervisory Board, where an agreement was reached for all of the 122 supervisory O&Ds that are addressed in the Regulation and the Guide. This package includes follow-up actions regarding 20 O&Ds as a final policy stance could not be formulated in full detail, or will not be fully operational until further developments, both internally and at EBA or Basel Committee level, are complete.

2 Results of the consultations with the interested parties and of the impact assessments

2.1 Impact assessment

Careful analysis of the current national implementation and practices has shown that for a majority of O&Ds, implementation of the proposed package does not have a material impact on bank balance sheets and operational costs. Indeed, national implementation is to some extent already harmonised due to the application of EBA standards, but further specification was needed in order to ensure appropriate harmonisation. The ECB has performed a quantitative analysis of the O&Ds that have the most significant and quantifiable immediate impact, as described below:

- Transitional arrangements for the definition of own funds (section 2.2.1): banks in participating Member States converge at various speeds towards a common definition of capital, which creates a temporary but material bias when looking at their current capital ratios. In particular, the analysis highlights the impact of allowing for a 10-year phase-in for the deduction of Deferred Tax Assets (DTAs), instead of 5 years as in the Basel 3 Accord (Article 478(3) CRR).
- The possibility to deduct holdings in insurance subsidiaries for banks subject to supplementary supervision under the Financial Conglomerates Directive (Article 49(1) CRR, section 2.2.2).

2.1.1 Transitional arrangements for the definition of own funds

2.1.1.1 General overview

The new CRR framework provides for more stringent rules as regards the level of capital requirements and the definition of capital. In order to smooth the transition towards this more rigorous regime for banks, the CRR framework provides for a gradual phase-in of the new rules (11 O&Ds in total). Competent authorities must, therefore, choose, within a more or less flexible timeframe, the pace according to which capital deductions and the removal of prudential filters have to be implemented, until the full effect of the new rules comes into play (in most cases in 2018).

Transitional arrangements are also foreseen in the Basel Committee framework, although they are relatively short (usually expiring in 2018).

As shown in Figure 1, the Comprehensive Assessment (CA) exercise has estimated that as at 1 January 2014, the CET1 impact of total transitional adjustments across all participating banks amounted to €126.2 billion.

When comparing "current" CET1 ratios to "fully loaded" CET1 ratios for the fourth quarter of 2014, i.e. the CET1 ratios obtained when disregarding all transitional rules, the results show that:

- the weighted average current CET1 ratio for SSM Significant Institutions amounts to 12.7%, while the fully loaded equivalent stands at 11.2%, i.e. 1.5 percentage points lower, consistent with the CA impact.
- the overall transitional adjustment is heterogeneous and differs across countries.

In addition, the relevance of different transitional rules varies across banks within individual countries.

2.1.1.2 Impact of the SB decision

On 17 July 2015, the Supervisory Board agreed to adopt a common approach for the treatment of all the transitional arrangements, namely to phase in the new capital definitions by 2018, following the internationally agreed pace. It was decided to maintain the existing national implementation of these arrangements, as long as this resulted in an even more prudent outcome than the agreed pace.

The policy agreed at Supervisory Board level has an impact on 2 O&Ds in particular:

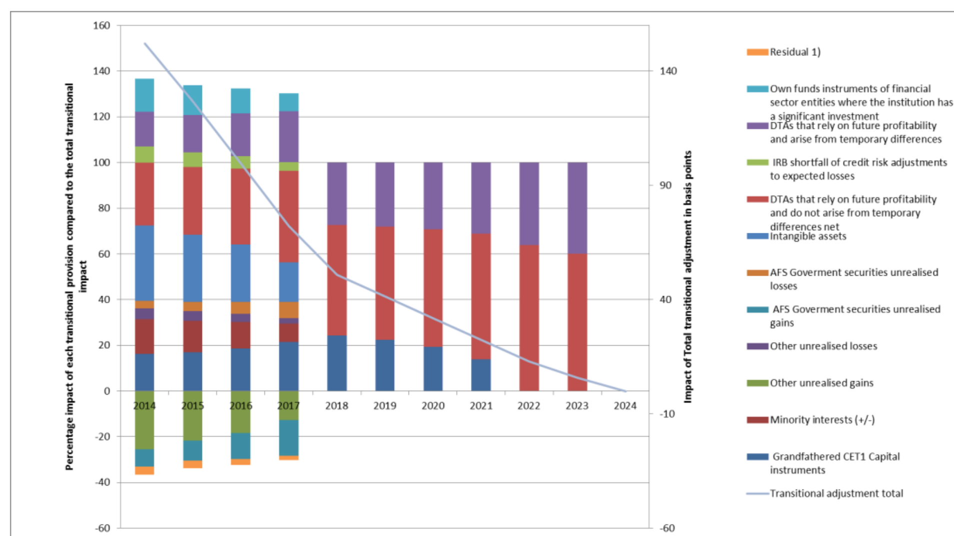
- Article 471(1) CRR, which allows banks not to deduct their holdings in insurance subsidiaries until 2022: The anticipation of the expiration will create a "cliff" effect, as this option will be phased out in 2018, together with most of the other transitional O&Ds (shown in lighter blue, on top of the bars in Figure 2).
- Article 478(3) CRR, which allows banks to phase in the deduction of Deferred Tax Assets relying on future profitability and existing before 1 January 2014 over 10 years, instead of the regular 5-year transition allowed in the Basel 3 accord (shown in purple and red in Figure 2[8]). As shown in Figure 2, the slower deduction of DTAs accounts for most of the impact of transitional arrangements. The compromise in the Supervisory Board[9], however, turns 10-year DTAs into 6-year DTAs (i.e. a 40% deduction is required in 2016, with a full deduction occurring in 2019), except for banks under restructuring plans for which a decision on whether to accelerate or to keep to the current pace will be made in 2020.Those banks are shown in red in Figure 3 below.

[8] The figure does not include DTAs that were converted into so-called Deferred Tax Credits (DTCs) which are independent from future profitability (e.g. in Spain (ES), Greece (EL), Portugal (PT) and Italy (IT)). In fact, the DTCs, established by national laws, are not affected by the O&D exercise conducted by the Supervisory Board.

[9] On this issue, it was also decided that banks could be exempted from the rule due to unforeseen and material impact of the adopted approach.

Figure 2

Breakdown by capital instrument (in percentage, left scale) of the total impact of transitional rules (expressed in basis points from 2014 to 2024, right scale)



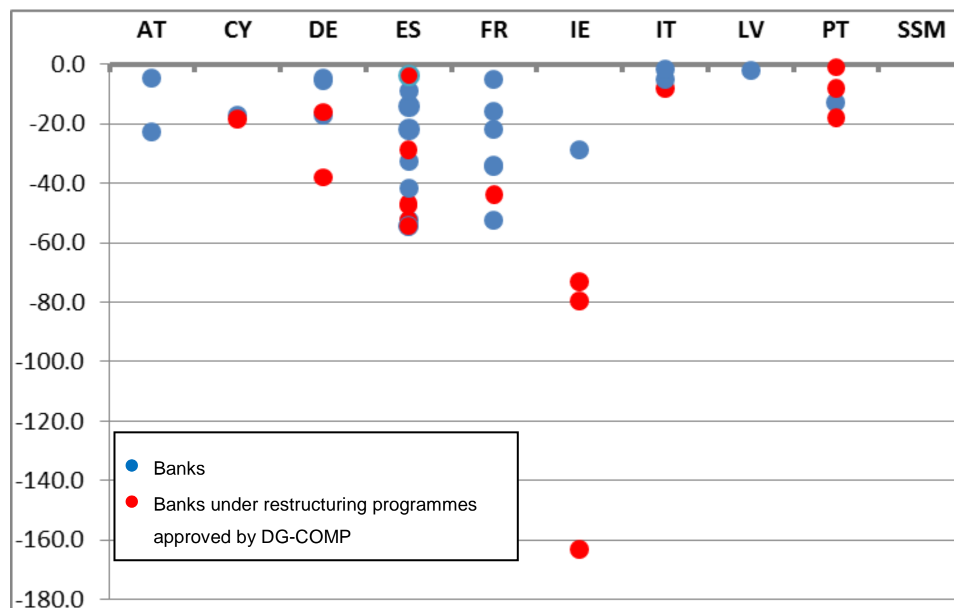
Source: ECB

1) Residual includes the following rules: assets which can alternatively be subject to 1.250% risk weight, holdings of CET1 capital instruments of FSE (not significant investment), additional transitional filters and deductions, change in excess deduction.

Figure 3

Impact of imposing a 40% deduction of DTAs vs the 10% currently required

(in basis points)



Source: ECB.

2.1.2 Non-deduction of insurance holdings

The general rule is to deduct from banks' own funds their significant holdings in insurance undertakings. As an exception to this rule, in the case of bank-led financial conglomerates, Article 49(1) CRR gives competent authorities the option, on a case-by-case basis, to allow such holdings not to be deducted and for them to be risk-weighted instead (100% to 370%), provided that a number of conditions are met. Since this O&D requires an *ex ante* case-by-case assessment, the ECB policy approach is laid out in the Guide.

A full deduction of insurance holdings would have had a significant impact on major bank-led conglomerates in the SSM. Indeed, when deducting the insurance holdings, the fully loaded CET1 ratios of relevant significant institutions (as indicated in Table 1) drop by 100 bp on average, from 11.41% to 10.41%. Therefore, the decision taken was to allow non-deduction while enhancing disclosure requirements. In addition, an intermediate approach is being explored, according to which only the Solvency II requirements of the insurance component would be deducted from the capital of the bank.

Table 1

Aggregated impact of status quo, full deduction and deduction of the capital requirements of the insurance component using both the current and fully loaded CET1 ratios

	Non-deduction	Full deduction	Option to be explored (deduction of insurance capital requirements)
CET1 ratio / 15 SI fully loaded (2018)	11.41%	10.41%	11.17%

Source: ECB

3 Legal elements of the proposal

Pursuant to Article 9(1) of the SSM Regulation, the ECB is the competent authority in the Member States of the SSM for the purpose of carrying out the microprudential and macroprudential tasks entrusted to it by the SSM Regulation. In this respect and with the limitations provided for in the SSM Regulation, the ECB is entrusted with, and can exercise, all the powers that competent and designated authorities have under Union law.

The list of the tasks entrusted to the ECB is provided for in Article 4(1) and (2) and Article 5(2) of the SSM Regulation and encompasses all tasks related to the prudential supervision of credit institutions.

To enable the ECB to carry out those tasks, Article 4(3) SSM Regulation provides that the ECB "shall apply all relevant Union Law, and where this Union Law is composed of Directives, the national legislation transposing those Directives". The same provision also states that "where the relevant Union Law is composed of Regulations and where currently those Regulations explicitly grant Options for Member States, the ECB shall apply also the national legislation exercising those Options". Furthermore, Recital 34 SSM Regulation envisages that the ECB should apply the national legislation exercising the Options granted to Member States by EU Regulations, but specifies that "such Options should be construed as excluding Options available only to competent or designated authorities".

The aim of those provisions is to preserve Member State competencies regarding either the transposition of Union law consisting of directives or the exercise of O&Ds included in regulations. However, the ECB is required to directly apply all relevant EU Regulations (including the CRR). This direct application includes the exercise of all O&Ds granted to competent authorities. In this regard, the ECB can introduce its own exercise of O&Ds provided for in the CRR and granted only to competent authorities (in theory regardless of their previously being exercised by national competent authorities) under certain conditions, with due respect for the legitimate expectations of supervised entities, where appropriate.

The majority of O&Ds in the CRR are granted only to competent authorities. Indeed, the O&Ds granted exclusively to competent authorities in the CRR comprise the main provisions pertaining to capital adequacy and liquidity requirements, including waivers of application of prudential requirements on a solo basis. Thus, the majority of provisions which are considered material by the ECB in order to carry out prudential supervision consistently across the SSM are O&Ds of this category. The ECB, therefore, enjoys considerable discretion in the exercise of those O&Ds.

Having in mind the abovementioned provisions, a taxonomy of O&Ds is developed below, according to the legal source of and the mandate for their exercise (i.e. whether the exercise of the option or discretion is granted to Member States or competent authorities). In this regard, six categories of O&Ds can be identified: a) CRDIV O&Ds granted only to Member States (e.g. Article 94(1)(g)); b) CRDIV O&Ds

granted only to competent authorities (e.g. Article 40); c) CRR O&Ds granted only to Member States (e.g. Article 412(5) part 1); d) CRR O&Ds granted only to competent authorities (e.g. Article 49(1)); e) CRDIV O&Ds alternatively granted to Member States or competent authorities (e.g. Article 94(1)(l)); f) CRR O&Ds alternatively granted to Member States or competent authorities (e.g. Article 450(1)(j)).

Concerning the competence for the exercise of O&Ds and with regard to credit institutions under direct ECB supervision, the following can be noted.

The ECB has wide latitude of discretion in exercising the O&Ds granted only to Competent Authorities and provided for in CRR, and which form the most important part of the O&Ds related to capital adequacy and liquidity requirements for prudential supervision. The O&Ds granted to Competent Authorities by CRD IV can be exercised by the ECB with due respect for the national implementing legislation. For the exercise of O&Ds with general application, a Regulation, as submitted in the current consultation, is an appropriate legal instrument. For the exercise of O&Ds applicable on a case-by-case basis, a supervisory decision addressed to a specific supervised entity would be the appropriate legal instrument. Nonetheless, for the latter category some general criteria for the exercise of case-by-case O&Ds can be developed as general guidance to ensure a consistent application of supervisory discretion. The Guide submitted in this consultation, which is an instrument of a non-legally binding nature, aims, among other things, at developing such general criteria. Case-by-case O&Ds can be subsumed under the SSM supervisory powers and exercised with individual decisions addressed to specific credit institutions, provided that these decisions are adequately motivated.

For the exercise of O&Ds by the ECB, the principle of legitimate expectations generated in supervised entities must be specifically taken into account. This also entails close cooperation with the NCAs, preliminary consultation with the supervised entities subject to the new exercise of O&Ds and the introduction of appropriate transitional periods (phase-in) prior to the entry into force of the new requirements.

The issue of legitimate expectations is even more relevant with respect to case-by-case options, given that supervisory acts (such as, for instance, waivers) addressed to specific credit institutions by the NCAs before the entry into force of the SSM might have created a presumption of compliance with regulatory requirements that cannot be overruled unless in the case of significant changes of circumstances. This notwithstanding, it must be considered that the very introduction of the SSM could constitute such a significant legislative change that might warrant by itself a change of regulatory policies under specific circumstances. In fact, supervised entities must be considered in the position, as “prudent economic operators”, to foresee that policies could be subject to review and modifications after the entry into force of the SSM and the consequent change in the competent supervisory authority entrusted with a new mandate explicitly encompassing also market integration and regulatory harmonisation within the SSM.

Be that as it may, legitimate expectations generated in supervised credit institutions must be safeguarded within the framework established by the relevant case law of the European Court of Justice.

The policy decisions taken by the ECB in the exercise of O&Ds must be communicated to the supervised entities in an appropriate and timely fashion, in order to avoid uncertainties regarding supervisory requirements currently in place. Moreover, it is important to underline that, in order to respect the principle of legal certainty, the exercise of O&Ds by the ECB cannot have retroactive effects vis-à-vis supervised credit institutions.

4 Detailed explanation of the proposal and policy rationale

As mentioned in section 1.2, the ECB has followed a defined set of principles underlying the design of a prudentially consistent framework for the exercise of O&Ds (prudence, rigorous harmonisation and consideration of internationally agreed standards). In addition to the common approach described in section 2.2.1 for transitional arrangements regarding the definition of own funds, a consistent policy line underpins the exercise of O&Ds relating to intragroup exposures and liquidity requirements (see section 5.1.2).

4.1 Content of the proposal

4.1.1 Structure of the proposal

Part I of the Regulation deals with the subject matter, scope and definitions used in the Regulation.

Part II of the Regulation lays out the harmonised exercise of general O&Ds. Its structure reflects the order of articles in the CRD 4 package:

- Chapter 1: Own funds (Article 89 CRR)
- Chapter 2: Capital requirements (from Article 178 to Article 380 CRR)
- Chapter 3: Large exposures (from Article 395 to Article 400 CRR)
- Chapter 4: Liquidity (from Article 412 to Article 420 CRR and Articles from the LCR Delegated Act)
- Chapter 5: Transitional provisions (from Article 467 to Article 495 CRR).

Section I of the Guide introduces the purpose, legal framework, scope, content and effect of the Guide as a non-binding instrument. Section II of the Guide lays out the harmonised policy approach adopted by the ECB regarding the case-by-case O&Ds and general O&Ds bearing no direct normative content, without a prior ECB action or assessment. The structure of that Section reflects the order of articles in the CRD IV package:

- Chapter 1: Consolidated supervision and waivers of prudential requirements (from Article 7 to Article 19 CRR)
- Chapter 2: Own funds (from Article 27 to Article 84 CRR)
- Chapter 3: Capital requirement (from Article 129 to Article 382 CRR)
- Chapter 4: Large exposures (Article 396 CRR)

- Chapter 5: Liquidity (from Article 414 to 425 CRR and Articles in the LCR Delegated Act)
- Chapter 6: Transitional provisions on capital requirements and reporting (Article 496 and 500 CRR)
- Chapter 7: General requirements for access to the activity of credit institutions (Article 21 CRD IV)
- Chapter 8: Acquisition of qualifying holdings (Article 22 CRD IV)
- Chapter 9: Governance arrangements and prudential supervision (from Article 76 to Article 142 CRDIV).

Section III of the Guide contains a description of the follow-up actions required for the 20 remaining O&Ds in the scope of the ECB O&D project and follows a similar structure to Section II. These O&Ds are mostly of a case-by-case nature. Nonetheless, it was considered appropriate to also include some O&Ds of a general application in this Section.

4.1.2 Policy rationale underlying the common approach for individual O&Ds

Liquidity Requirements according to Article 8 and Part 6 of the CRR, LCR Delegated Act: The ECB has adopted a unified approach to deal with the application of waivers and O&Ds relating to liquidity requirements, aiming at incentivising institutions to apply the sequence shown below.

1. The phase-in regime defined in the Basel standard and provided for in Part 6 and Article 460 of the CRR, as completed by the LCR Delegated Act and the present Regulation, should be kept as the guiding reference. In practical terms, this means the requirement of 60% LCR in 2015 is applicable to all institutions, notwithstanding any carve out, exemption or preferential treatment provided for in the CRD IV package and LCR Delegated Act, while any specific liquidity risks are addressed by means of Pillar 2 measures.
2. In a first stage, applications by the institutions for liquidity waivers, i.e. the constitution of liquidity subgroups, should be assessed based on specific criteria laid out in the Guide, before any other options that could increase the actual level of LCR of applicant institutions is taken into account (such as preferential treatment on intragroup flows or exemptions to the cap on inflows).
3. At a second stage, in those cases where the ECB did not grant the liquidity waivers requested following the assessment mentioned in point 2 above, applications for preferential treatments and exemptions could then be examined, based on the strict conditions defined in the Delegated Act and specified in the Guide.

Exposures and requirements within a group (Articles 7, 8, and 400(2)(c) CRR): One of the main areas where waivers and other individual exemptions are possible is the cross-border intragroup exposures regime, notably in the new liquidity framework, following the introduction of the LCR from October 2015 onwards. But the broader capital requirements can also be waived at the level of single subsidiaries operating within the same Member State in order to focus supervision at the level of the consolidating entity.

In line with the objective of fostering financial integration and improving the efficiency of the consolidated supervision of significant institutions, the single policy approach adopted by the ECB provides for the possibility of granting domestic waivers of prudential requirements at solo level.

In the specific case of the liquidity cross-border waiver (Article 8 (3) CRR), the ECB policy stance as reflected in the Guide strikes a balance between the general objective of pursuing financial integration and addressing national ring-fencing that followed the financial crisis on the one hand, and the need for prudence as the Banking Union is not yet complete, on the other. Therefore, significant subsidiaries are required to hold an amount of high quality liquid assets (HQLA) at least equal to the lower of: (a) the percentage of HQLA required at the ultimate parent company level, or (b) 75% of the level of HQLA that would be required in order to comply with the fully-phased-in LCR requirements at the solo or sub-consolidated level, in accordance with the Commission Delegated Regulation (EU) 2015/61.The aim is to migrate to a 50% lower bound in 2018 based on the degree of satisfaction of the Supervisory Board regarding the institutional and economic progress of the Banking Union. Reporting would generally be maintained in the case of cross-border waivers and would be waived on a case-by-case basis for domestic waivers, except in the case of Institutional Protection Schemes (no reporting waiver).

As far as large exposure limits are concerned, the intragroup exemption provided by the ECB in accordance with Article 400(2)(c) CRR is intended to ensure that application is limited to those entities which are subject to equivalent prudential requirements, according to the criteria laid out in Article 400(3) CRR and specified in Annexes 1 and 2 of the Regulation. The application of the exemption does not jeopardize the reporting requirements provided for in Commission Implementing Regulation No 680/2014.

Non-deduction of insurance holdings according to Article 49(1) CRR: In the case of banks within a financial conglomerate under Directive 2002/87/EC, the CRR provides for a specific prudential treatment of insurance holdings. As a general rule, Article 36(1) CRR envisages that significant holdings in insurance undertakings should be deducted from banks' own funds. As an exception to this rule, Article 49(1) CRR grants the option to competent authorities, if requested by banks, to allow them not to deduct such holdings and to risk weight them instead (100% to 370%), provided that a number of CRR conditions are met. In this respect, the ECB considers that the application of Directive 2002/87/EC should imply neither a regulatory advantage, nor less comparability of CRR ratios between conglomerates and non-conglomerates. The Supervisory Board has decided to keep the status quo, i.e. decisions according to Article 49 CRR taken before 4 November 2014 will

continue to apply for the time being. Incoming applications for new decisions will be assessed according to the CRR criteria. With regard to both existing and new decisions, the Supervisory Board is of the view that disclosure requirements shall be enhanced. It will explore, in coordination with the EBA and the Commission, proposals on how the CRR text could be interpreted or modified, so as to remove the double gearing of capital at the level of the sectorial requirements and yet maintain an incentive to provide the insurance component of the conglomerate with adequate capital – an incentive that would be reduced in the case of full deduction from the bank's capital.

4.2 O&Ds requiring follow-up actions

For the 20 O&Ds contained in Section III of the Guide, the ECB has decided on a preliminary high-level policy direction and has determined specific follow-up items, as indicated below:

- Article 24(2) CRR on the competent authority's option to require the use of international financial reporting standards (IFRS): A specialised work stream will assess the costs and benefits of exercising this O&D. The single ECB policy will be enforced via the Regulation.
- Numerous and material discrepancies were identified in the implementation of Article 116(4) CRR, which allows supervisors to assimilate the risks of exposures to public sector entities (PSEs) to the risks of exposures to central government (risk-free), regional government or local authorities (risk-free or 20% risk weight). The current practices are relatively heterogeneous with regard to admitting PSEs to this treatment. The agreement reached was to exercise the option, take stock of the national lists of eligible PSEs and develop further guidance on the exercise based on a review of those lists. The ECB will then publish a common list of PSEs.
- Two O&Ds in Articles 124 and 164 of the CRR allow supervisors to impose, on the basis of financial stability concerns, stricter conditions on the calculation of capital requirements for real estate exposures. In the light of financial stability considerations, these O&Ds will be exercised in close cooperation with the macroprudential authorities. Moreover, within the SSM there are different real estate markets with different features and different levels of risks. In this light it is necessary to adopt a common methodology which takes all these different aspects into account. The adopted policy recommendation to exercise this option will not be fully operational until this methodology has been developed together with the EBA.
- For some O&Ds, it is suggested that the policy recommendations be formulated or amended at a later stage, in order to take developments at the EBA and European Commission into account. For other O&Ds, it is recommended that specifications be developed at a later stage, after concrete cases arise and further experience is gained.