COMMISSION OF THE EUROPEAN COMMUNITIES

COM(91) 68 final - SYN 333

Brussels, 23 April 1991

Proposal for a

COUNCIL DIRECTIVE

on monitoring and controlling large exposures

of credit institutions

(presented by the Commission)

EXPLANATORY MEMORANDUM

A. General

Risk spreading is a golden rule of financial activity in general. It is the prime responsibility of the supervisory authorities to ensure that this rule is closely observed by credit institutions. In the area of credit risks, too great a concentration of exposures to any one party could jeopardize the independence of the credit institution's management and, in the event of that party failing, could cause it such a loss as to threaten its stability.

This is therefore a key rule of supervision which should be harmonized at Community level. Furthermore, specific mention of this was made in the Commission's White Paper on completing the internal market. However, there is a second reason for such harmonization, namely the need to prevent clear distortion of competition. As the rules governing the division of risks are primarily intended to limit the assistance which a credit institution may grant a given client, another institution would have a competitive advantage if it were subject to less stringent rules.

In line with the objectives set out in the White Paper, the Commission adopted, in 1986, a Recommendation on large exposures[1] in order to prepare credit institutions and Member States gradually for the adoption of binding standards. A recital in that Recommendation specifically promised a later proposal for a Directive. The approaching internal market deadline and the agreement reached by the national supervisory authorities within the Banking Advisory Committee suggest that the time is ripe for a proposal for a Directive to be adopted.

The attached proposal for a Directive submitted for the Commission's approval contains stricter standards than those set out in the Recommendation. Mentioning only the key rules, the absolute limit on exposures to a single client has been set at 25% of the lending credit institution's own funds (the corresponding percentage in the Recommendation was 40%), while the threshold at which an exposure is considered to be a large exposure has been reduced to 10% of the lending institution's own funds (from 15% in the Recommendation).

This reinforcement of standards is in response to the earnestly expressed wishes of the Banking Advisory Committee and is also supported in a document on sound practices presented by the Basle Committee on banking supervision at the recent world conference of bank inspectors in Frankfurt. Stricter standards can only reinforce the solidity and stability of the Community's banking system. Furthermore, a limit of 25% of the lending institution's own funds can in no way be regarded as excessively low,

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1 Commission Recommendation of 22 December 1986 on monitoring and controlling large exposures of credit institutions, OJ No L 33, 4.2.1987, p. 10.

since, if a client to which such a large exposure had been incurred were to fail, the credit institution could lose a quarter of its own funds, which is a considerable amount and should, ideally, be reduced still further. Moreover, this is a ceiling, and credit institutions should discipline themselves to reach or near that ceiling only in the case of exposures of impeccable quality.

Nevertheless, the significant reduction in the ceiling compared with that in the Recommendation may pose adjustment problems for some credit institutions or, in a more structural manner, for certain banking systems or parts of banking systems. Furthermore, assistance already granted in excess of 25% of own funds cannot always be reduced quickly by credit institutions which are contractually bound to the recipients of that assistance. Accordingly, the attached proposal contains a provision authorizing the competent authorities to grant credit institutions a maximum period of five years in which to bring existing exposures into line with the limits laid down; in addition, loans of longer maturity with contractually binding terms for the lending institution, may be held until maturity.

B. Comments on the Articles

Article 1: Definitions

The definitions in this Article are drawn mainly from other Community Directives or proposals for Directives in the banking sphere and their retention is justified in the interests of consistency.

However, two definitions are peculiar to this proposal and merit special comment.

The first of these is the definition of "exposures" (letter h) of the definitions). The above-mentioned Commission Recommendation defined exposures as any facility granted, whether drawn or undrawn, by a credit institution to a client or group of connected clients, on or off balance sheet, and includes those commitments and contingent items deemed to be relevant by the respective competent authorities when assessing the identifiable risks of that institution. A list of exposures was set out, for guidance, in the Appendix to the Recommendation.

Since then, the solvency ratio Directive[1] has been adopted, which contains a detailed nomenclature of risks. By referring to this nomenclature, it is possible to have both a more precise and a more binding definition of exposures. It should be emphasized, however, that this borrowing from the solvency ratio Directive covers only the risk nomenclature and not the weightings attributed to the risks in the Directive according to the party or degree of risk involved in the transaction. These weightings in Directive 89/647/EEC were not designed to measure exposure to an individual client but instead to set up a general solvency requirement to cover the credit risk of credit institutions. Given the fundamental aim underlying the rules on risk spreading (to limit an institution's maximum risk of loss with respect to a given client), a prudent approach must take account of exposures at their nominal value, without any weighting or degree of risk.

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1 Council Directive 89/647/EEC of 18 December 1989 on a solvency ratio for credit institutions, OJ No L 386, 30.12.1989, p. 14.

It will be noted that the definition of exposures also includes underwriting commitments for the issue of securities. The amount taken into account is the institution's net commitment, subject to deduction of the shares transferred to other credit or financial institutions.

The second definition peculiar to this proposal is that of a "group of connected clients" (letter m) in Article 1). This definition is very similar to that in the 1986 Recommendation. The first part of the definition refers to the existence of a power of control as defined in the eleventh indent in Article 1. The second part refers to a de facto interconnection resulting from certain links, examples of which are set out in the proposal for guidance. The competent authorities will be responsible for examining the combinations of exposures incurred by credit institutions on the basis of the rules transposing this definition into national law and for assessing whether those combinations of exposures are in fact consistent with the letter and spirit of the Community definition. In order to give the competent authorities the necessary flexibility in an area which depends more on economic appraisal than on legal criteria, the proposal makes it clear that the combined exposure presumptions in the definition are relative presumptions which can be reversed if there is proof to the contrary.

Article 2: Scope

The Directive will apply to credit institutions which have obtained the authorization referred to in Article 3 of Directive 77/780/EEC of 12 December 1977 (first coordination Directive),[1] i.e. all the credit institutions in the Community. However, Member States will not have to apply the Directive to:

1 OJ No L 322, 17.12.1977, p. 30.

- institutions permanently excluded from the scope of the first coordination Directive (mainly central banks, post office giro institutions and certain particular institutions in each Member State);

- credit institutions permanently affiliated to a central body which supervises them and which is established in the same Member State, and provided that the conditions set out in Article 2(4)(a) of Directive 77/780/EEC are met. In that case, without prejudice to the application of the Directive to the central body, the whole - constituted by the central body and its affiliated institutions - must be the subject of global supervision with regard to large exposures.

Article 3: Reporting of large exposures

Effective supervision of large exposures clearly calls for such exposures to be notified regularly to the competent authorities. Such is the aim of Article 3.

Paragraph 1 of Article 3 stipulates that large exposures must be reported to the competent authorities. At their discretion, Member States will provide for this reporting to be carried out by one of the following methods:

- notification of all large exposures at least once a year, backed up by communication during the year of any modifications to the annual notification;

- notification of all large exposures at least four times a year.

The first of these two methods, which did not appear in the Recommendation, was suggested to the Commission by the Banking Advisory Committee.

As to the second method, the minimum frequency of notification has been increased to four times a year from the single report provided for in the Recommendation. Effective monitoring of large exposures presupposes that sufficiently frequent information reaches the supervisory authorities. Moreover, one of the recitals in the Recommendation suggested that the competent authorities should seek more frequent reporting.

Member States will have the choice of transposing into national law either one of these methods only or both methods. In the latter case, they will be able to decide whether the choice of method should be left to the competent authorities or to the credit institution itself.

Paragraph 2 of Article 3 stipulates that an exposure to a client or group of connected clients is to be considered a large exposure where its value is equal to or exceeds 10% of the lending institution's own funds. The corresponding percentage in the Recommendation was 15%. The reduction in this threshold is justified by the general need to make the system of supervising large exposures more stringent in order to reinforce the stability of the Community's banking system. More specifically, once the ceiling on individual exposures has itself been cut (see Article 4(1) below), it is logical to reduce the reporting threshold. Some countries already employ a 10% threshold, and the Commission considers, in the light of their experience, that such a threshold cannot be regarded as imposing bureaucratic obligations. Since the proposal also provides for an aggregate limit on large exposures of 800% of own funds (see Article 4(3) below), the reporting exercise is limited to a theoretical maximum of 80 exposures. Moreover, this reporting exercise can easily be computerized.

The reduction in the threshold to 10% will ease administrative obligations in a further respect. The Commission has not retained paragraphs 3 and 4 of the corresponding Article in the Recommendation, which provided for a credit institution's ten largest exposures to be reported, whether or not these were "large exposures". The Banking Advisory Committee agreed that such reporting would lose much of its value as a result of the widening of the concept of "large exposure". As to the supervision of institutions which do not have exposures in excess of 10% of their own funds, this is, by definition, not subject to legislation governing the spreading of large exposures.

Article 4

Paragraph 1

This key provision in the draft Directive stipulates that credit institutions may not incur an exposure to a client or group of connected clients where its value exceeds 25% of own funds. This represents an appreciable reduction compared with the Recommendation, which provided for a 40% ceiling. Apart from the fact that the introduction of stricter standards more than four years after the adoption of the Recommendation, which was only an initial stage, is a logical step, this reinforcement of the standard was specifically called for by a significant majority of the Banking Advisory Committee, subject to a transitional period for existing exposures (see Article 6 below). Support for a 25% ceiling can also be found in a document presented by the Basle Committee on banking supervision at the world conference of bank inspectors held in Frankfurt in October 1990.

A 25% ceiling should not be regarded as excessively low since, while complying with that limit, a credit institution could still, under the worst hypothesis, lose a quarter of its own funds. This is a considerable amount and should, ideally, be reduced further. The point is that this is a maximum ceiling for exposures of impeccable quality, and credit institutions should discipline themselves to reach or approach that limit only in the case of exposures of such quality.

Paragraph 2

Bank supervisors know from experience that there is frequently an increased risk where a credit institution lends to enterprises linked to it. The Banking Advisory Committee specifically requested the Commission to provide for a lower limit for exposures to associated enterprises (parent undertaking of the credit institution and other subsidiaries of that parent undertaking). It had initially been planned to incorporate such a provision in the proposal for a Directive relating to the supervision of credit institutions on a consolidated basis.[1] But, as indicated in the fourth recital of that proposal, it was considered preferable to settle this question in a more systematic manner within the framework of the future Directive on large exposures.

The Commission has set this lower limit at 20% (compared with the normal 25% limit laid down in paragraph 1).

Provision is made for exceptions to this rule in paragraphs 5 and 6 (see below).

1 COM(90) 451, OJ No C 315, 14.12.1990, p. 15.

Paragraph 3

The Commission has retained the aggregate limit on large exposures provided for in the Recommendation, i.e. 800% of own funds. However, as the concept of "large exposure" has been broadened (see Article 3(2) above), this limit has now become, indirectly, more strict.

An aggregate limit is a valuable complement to the limitation of individual risks in legislation governing large exposures. While the limitation of individual risks ensures that no exposure exceeds the ceiling laid down, it does not affect the spread of risks throughout the portfolio. An aggregate limit of 800%, however, will mean that a credit institution can at most have 80 large exposures and a maximum of 32 exposures which reach the individual ceiling of 25% of own funds.

Paragraph 4

This paragraph provides that Member States may impose more stringent limits than those laid down in paragraphs 1, 2 and 3.

Paragraph 5

This paragraph requires the limits laid down in the first three paragraphs to be observed at all times. If those limits were to be exceeded - which could happen accidentally - the proposal stipulates that they may be exceeded only in exceptional and temporary circumstances and, in such cases, the competent authorities would have to fix a deadline within which the credit institution would be obliged to regularize its situation.

Paragraph 6

This paragraph permits Member States to exempt fully or partially from the need to observe the special 20% limit laid down in paragraph 2 exposures incurred by the credit institution to a financial holding company which is

its parent undertaking and to other subsidiaries of that financial holding company which are credit institutions, financial institutions or undertakings providing ancillary banking services.

The presumption of increased risk underlying the special 20% limit applicable to exposures to associated undertakings is not necessarily relevant in the case of exposures to banking and financial entities in the group. In that event, however, the group should structure itself in such a way that those entities can be the subject of supervision on a consolidated basis exercised in accordance with the future Directive in this field (see the reference above to the proposal for a Directive presented by the Commission).

Paragraph 7

This paragraph permits Member States to exempt fully or partially from all the limits laid down in paragraphs 1, 2 and 3 (but not from the reporting obligations set out in Article 3) exposures incurred by the credit institution to:

- its parent undertaking, provided that that undertaking is itself a credit institution. It does not seem justified to limit the flow of funds which a subsidiary can provide for its parent credit institution. Of course, the proviso here is again that the parent undertaking is subject either to supervision on a consolidated basis exercised in accordance with the Community Directive in question or, if it is located in a third country, to equivalent supervision;

- subsidiaries, provided that those subsidiaries are credit institutions, financial institutions or undertakings providing ancillary banking services. Since these are activities which the

credit institution could carry out directly, there is no reason to limit the funding which it provides for its subsidiaries. Once again, the exemption is subject to the proviso that the subsidiaries in question are included in the consolidated supervision of the parent undertaking.

Paragraph 8

This paragraph authorizes Member States to exempt a number of specific exposures fully or partially from the application of the limits laid down in paragraphs 1, 2 and 3.

The first six indents (letters a) to f)) cover exposures incurred directly or indirectly to Zone A central governments and central banks and to the European Communities. No Member State imposes or seems prepared to impose limits on exposures incurred by its credit institutions to itself. Given the rule of non-discrimination within the Community, this lack of limitation should in any case apply to exposures incurred to other Member States. But, for reasons similar to those given in connection with the above-mentioned Directive 89/647/EEC or the proposal for a Directive on capital adequacy of investment firms and credit institutions,[1] it seems pertinent to refer to a wider geographical area, namely Zone A as defined in Directive 89/647/EEC.

Letters g) and h) cover cases where the risk can be considered to be small or even nil, i.e. where it is covered by a guarantee in the form of cash deposits or certificates of deposit lodged with the lending institution.

Letter i) covers claims with a maturity of up to one year on other credit institutions. The aim here is to cover transactions on the interbank market. This is a market which operates between professionals who know each other and which requires some flexibility in order to function harmoniously. The Commission does not therefore consider it appropriate,

1 COM(90) 141; OJ No C 152, 21.6.1990, p. 6.

at this stage, to establish a single harmonized limit at Community level for exposures incurred on this market.

The same reasoning applies to letter j), which concerns commercial paper meeting certain conditions, and to letter k), which concerns the obligations defined in article 22 paragraph 4 of directive 85/611/EEC on UCITS[1].

Letter l) covers cooperative banks or savings banks belonging to a network and for which there is a centralized cash clearing operation.

Paragraph 9

Paragraph 9 refers to exposures incurred directly or indirectly to regional and local authorities in the Member States. In view of the fact that the degree of risk involved here is normally lower, the proposal permits a 20% weighting to be applied. This rate may be reduced to 0% subject to the conditions laid down in Article 7 of Directive 89/647/EEC. Given the wide differences which may exist between the rules governing regional and local authorities outside the Community, the Commission does not consider it appropriate to extend this arrangement to the whole of Zone A.

Paragraph 10

This paragraph states, as a general principle, that where an exposure to a client is guaranteed, to the satisfaction of the competent authorities, by a third party, the competent authorities may deem the exposure to have been incurred to that third party and not to the client. Thus, where, for example, a credit institution incurs an exposure of 50 to client A and one of 20 to client B, but with client B guaranteeing 10 of A's debt to the credit institution, the exposure to A and B may be deemed to be as follows:

- A: 40
- B: 30.

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1 OJ No L 375, 31.12.1985, p. 3.

Article 5: Supervision on a consolidated or non-consolidated basis

This Article includes provisions already adopted as part of Directive 89/647/EEC on a solvency ratio, and in particular Article 3(2) to (6) of that Directive.

Paragraph 1 covers the case of a credit institution which is neither a parent undertaking nor a subsidiary.

Paragraph 2 establishes the principle of applying the rules set out in Articles 3 and 4 on a consolidated basis.

Paragraph 3 lays down the arrangements for the non-consolidated supervision of a parent credit institution and its subsidiaries established in the same Member State.

Paragraph 4 concerns the supervision, on a non-consolidated basis, of subsidiaries established in other Member States.

Paragraph 5 provides for possible bilateral agreements under which the competent authorities in the Member State in which a subsidiary is situated could delegate their responsibility for supervision to the competent authorities in the Member State in which the parent credit undertaking is established.

Article 6: Transitional provisions relating to exposures in excess of the limits

Article 6 concerns exposures existing at the time the Directive is published in the Official Journal of the European Communities which exceed the limits laid down by the Directive. It would seem justified to make transitional arrangements for this type of exposure, in order to allow credit institutions the time to find a solution which would not overturn their commercial relationship with their clients. In any event, credit

institutions may be bound - with regard to the parties to whom those exposures have been incurred - by contractual arrangements which do not necessarily permit them to reduce such exposures quickly.

Paragraph 1 specifies that risks entered into force before the date of publication of the directive in the Official Journal of the European Community shall be eligible for the grandfathering provisions. The choice of this cut-off point is justified by the consideration that from the moment when the directive is published, credit institutions should not be able to take exposures exceeding the limits that will apply subsequently.

This paragraph also stipulates that the competent authorities must require the credit institution in question to take the steps necessary to have the excess exposure or exposures brought into line with the provisions of the Directive.

Paragraph 2 provides for the process of reducing the excess exposures to be implemented and completed within the period deemed by the competent authorities to be consistent with the principle of sound administration and fair competition. The competent authorities are required to inform the Commission and the Banking Advisory Committee of the schedule for the general process adopted.

In accordance with paragraph 4, however, the period in question may not exceed five years from the date stipulated in Article 8(1), i.e. 1 January 1993. However loans with a longer maturity with binding contractual terms for the credit institution may be held until maturity.

Paragraph 3 stipulates that, credit institution may only take advantage of the period specified in paragraph 2 to the extent that it does not take any measure which would cause the exposures to exceed the level existing at the date of publication of the directive in the Official Journal. The emphasis is therefore on the deliberate action of the credit institution.

Finally, paragraph 5 contains a specific provision which Member States may apply to the particular categories of credit institution referred to in Article 4(2) of Directive 89/646/EEC. This provision is justified by the fact that, as the own funds of such institutions are limited, immediate application of the 25% rule would reduce their lending activity too abruptly. The arrangements set out in paragraph 5 can be summarized as follows:

- from 1 January 1993 to 31 December 1997, the institutions in question may be subjected to a limit of 40% instead of the 25% limit laid down in Article 4(1); in that event, all new exposures incurred by such institutions are to be subject to that 40% limit;

- exposures existing on the date the Directive is published in the Official Journal may be maintained, whatever their level, until 31 December 1997, subject to the sole proviso that they may not be increased beyond the level reached on the date of publication;

- as from 1 January 1998, the 25% limit will come into force and will apply to all new exposures;

- however, exposures between 25% and 40% of own funds existing at the end of the maximum period of five years (i.e. in principle on 31 December 1997) may be maintained for a maximum period of three years (i.e. until 31 December 2000), subject to the same condition that they may not be increased;

- as from 1 January 1998, therefore, no exposure in excess of 40% of own funds may be maintained, and, as from 1 January 2001, no exposure in excess of 25% of own funds may be maintained;

- paragraph 4 provides, however, that loans with a longer maturity than the dates referred to above and with binding contractual terms for the lending credit institution may in all cases be maintained until maturity.

Article 7: Subsequent amendments

Paragraph 1 specifies the fields in which the procedure for making technical amendments to the Directive are to apply. The first three indents concern the adaptation of definitions or terminology. The fourth relates to the frequency of large exposure reporting ((Article 3(1)). The fifth indent concerns the clarification or extension of the exemptions provided for in Article 4(5) to (9). The sixth indent, finally, refers to the maximum period for reducing the excess exposures outstanding at the time of the publication of the Directive in the Official Journal of the European Communities. This maximum period laid down in Article 6(4) is five years.

The procedure laid down in paragraph 2 is Procedure III, Variant (a), in Council Decision 87/373/EEC of 13 July 1987 laying down the procedures for the exercise of implementing powers conferred on the Commission.

Article 8: Final provisions

The first subparagraph of paragraph 1 requires Member States to comply with the Directive by 1 January 1993.

The second subparagraph stipulates that, when Member States adopt the necessary provisions of national law, these must contain a reference to this Directive or must be accompanied by such reference when they are officially published.

Paragraph 2 deals with the transmission to the Commission of the main provisions of national law adopted by the Member States.

Article 9

This Article contains the usual wording to the effect that the Directive is addressed to all Member States.

Proposal for a

COUNCIL DIRECTIVE

on monitoring and controlling large exposures of credit institutions

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THE COUNCIL OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community, and in particular the first and third sentences of Article 57(2) thereof,

Having regard to the proposal from the Commission[1],

In cooperation with the European Parliament[2],

Having regard to the opinion of the Economic and Social Committee[3],

Whereas this Directive is consistent with the aims set out in the Commission's White Paper on completing the internal market[4];

Whereas the suitable approach is to achieve harmonization of essential supervisory rules; whereas Member States should have the option of adopting more stringent provisions than those provided for by this Directive;

Whereas this Directive has been the subject of consultation with the Banking Advisory Committee, which is responsible, under Article 6(4) of Council Directive 77/780/EEC of 12 December 1977 on the coordination of

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4 COM(85)310.

laws, regulations and administrative provisions relating to the taking-up and pursuit of the business of credit institutions[1], as last amended by Directive 89/646/EEC[2], for making suggestions to the Commission with a view to coordinating the coefficients applicable in the Member States;

Whereas monitoring and controlling the exposures of a credit institution is an integral part of prudential supervision; whereas excessive concentration of exposures to a single client or group of connected clients may result in an unacceptable risk; whereas such a situation may be deemed to be prejudicial to the solvency of a credit institution;

Whereas common guidelines for monitoring and controlling exposures of credit institutions were introduced initially by Commission Recommendation 87/62/EEC[3]; whereas that instrument was chosen since it permitted existing systems to be adjusted gradually and new systems to be established without causing dislocation to the banking system of the Community; whereas, with that first phase now over, it is necessary for a binding instrument to be adopted, applicable to all Community credit institutions;

Whereas credit institutions in a unified banking market engage in direct competition with each other and the prudential supervision requirements throughout the Community should, therefore, be equivalent; whereas, to that end, the criteria applied for determining the concentration of exposures should be the subject of legally binding rules at Community level and cannot be left entirely to the discretion of the Member States; whereas the adoption of common rules will therefore best serve the interests of the Community, since it will prevent differences in competitive conditions, while at the same time strengthening the Community's banking system;

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1 OJ No L 322, 17.12.1977, p. 30.

2 OJ No L 386, 30.12.1989, p. 1.

3 OJ No L 33, 4. 2.1987, p. 10.

Whereas as regards the precise accounting technique to be used for assessing exposures, reference is made to the provisions of Council Directive 86/635/EEC of 8 December 1986 on the annual accounts and consolidated accounts of banks and other financial institutions[1];

Whereas Council Directive 89/647/EEC of 18 December 1989 on a solvency ratio for credit institutions[2] contains a list of credit risks which may be incurred by credit institutions; whereas it is therefore justified to refer to that list in the definition of exposure for the purpose of this Directive; whereas it is not, however, appropriate to refer to the weightings or degrees of risk set out by Directive 89/647/EEC; whereas these weightings and degrees of risk have been devised in order to set up a general solvency requirement to cover the credit risk of credit institutions; whereas in the framework of regulating large exposures, the purpose is to limit the maximum potential loss that a credit institution may incur through a single client or a group of related clients; whereas it is therefore appropriate to adopt a prudent approach consisting of taking account of the nominal value of exposures, without application of any weightings or degree of risk;

Whereas when a credit institution has an exposure to its own parent undertaking, or to other subsidiaries of its parent undertaking, particular prudence is justified; whereas the management of exposures incurred by credit institutions must be carried out in a fully autonomous manner, with respect to the principles of sound banking management, without regard to any other considerations beyond these principles; whereas the provisions of the Second Council Directive 89/646/EEC of 15 December 1989, on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions and amending Directive 77/780/EEC, require that where the influence exercised by persons holding a qualifying participation in a credit institution directly or indirectly is likely to operate to the detriment of

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1 OJ No L 372, 31.12.1986, p. 1.

2 OJ No L 386, 30.12.1989, p. 14.

the prudent and sound management of the institution, the competent authorities shall take appropriate measures to put an end to that situation; whereas in the large exposures field, it is justified to insert specific rules with respect to an exposure held by a credit institution on its own group, and in such cases more stringent limitations are justified for such exposures than for other exposures; whereas this more stringent limitation must however not be applied when the parent undertaking is a financial holding company or a credit institution, and the other subsidiaries which are either credit or financial institutions, or undertaking offering ancillary banking services, to the extent that all these undertakings are included in the supervision on a consolidated basis of the credit institution; whereas in that case, the supervision on a consolidated basis of the group allows sufficiently efficient supervision, without the imposition of more stringent limits on exposure being needed; whereas under this approach, banking groups will also be encouraged to organize their structure in such a way as to make consolidated supervision possible, which is a desirable result because it allows more comprehensive supervision to be carried out;

Whereas it is necessary to provide for a two-stage application of the limit of 25% of own funds in the case of the particular categories of credit institution referred to in Article 4(2) of Directive 89/646/EEC; whereas, the own funds of such institutions being limited, a single-stage application of the 25% rule would reduce their lending activity too abruptly;

Whereas implementing powers of the same nature as those which the Council reserved for itself in Directive 89/299/EEC of 17 April 1989 on the own funds of credit institutions[1] were granted to the Commission in Directive 89/646/EEC;

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1 OJ No L 124, 5.5.1989, p. 16.

Whereas, taking account of the specific characteristics of the sector in question, it is appropriate to give the committee provided for in Article 22 of Directive 89/646/EEC the role of assisting the Commission in carrying out the responsibilities granted to it according to the rules of procedure laid down in Article 2, Procedure III, Variant (a) of Council Decision 87/373/EEC of 13 July 1987 laying down the procedures for the exercise of implementing powers conferred on the Commission[1],

HAS ADOPTED THIS DIRECTIVE:

1 OJ NO L 197, 18.7.1987, p. 33.

Article 1

Definitions

For the purpose of this Directive:

(a) "credit institution" means a credit institution as defined in the first indent of Article 1 of Directive 77/780/EEC and includes branches of such institutions in third countries and all private or public undertakings, including their branches, which satisfy the definition given in the first indent of Article 1 of Directive 77/780/EEC and which have been authorized in a third country;

(b) "competent authorities" means the competent authorities as defined in the ninth indent of Article 1 of Directive ... (supervision on a consolidated basis);

(c) "parent undertaking" means a parent undertaking as defined in Articles 1 and 2 of Council Directive 83/349/EEC[1];

(d) "subsidiary undertaking" means a subsidiary undertaking as defined in Articles 1 and 2 of Directive 83/349/EEC; any subsidiary undertaking of a subsidiary undertaking shall be deemed to be a subsidiary of the parent undertaking which is at the head of those undertakings;

(e) "financial holding company" means a financial holding company as defined in the third indent of Article 1 of Directive ... (supervision on a consolidated basis);

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1 OJ No L 193, 18.7.1983, p. 1.

(f) "financial institution" means a financial institution as defined in the sixth indent of Article 1 of Directive 89/646/EEC;

(g) "ancillary banking services undertaking": an undertaking as defined in Article 1, fifth indent, of Directive ..... (supervision on a consolidated basis);

(h) "exposures" means: the assets and off-balance-sheet items listed in Article 6 of Directive 89/647/EEC and in Annexes I and III thereto, without application of the weightings or degrees of risk set out in those provisions; the risks mentioned in Annex III must be calculated in accordance with the method set out in Annex II to that Directive, without application of the weightings for counterparty risk; the underwriting commitments for the issue of securities are included, subject to deduction of the shares transferred to other credit or financial institutions;

(i) "Zone A" means the zone defined in the second indent of Article 2 of Directive 89/647/EEC;

(j) "Zone B" means the zone defined in the third indent of Article 2 of Directive 89/647/EEC;

(k) "own funds" means the own funds of a credit institution within the meaning of Directive 89/299/EEC;

(l) "power of control" means the relationship between a parent undertaking and a subsidiary, as defined in Articles 1 and 2 of Directive 83/349/EEC, or a similar relationship between any natural or legal person and an undertaking;

(m) "group of connected clients" means two or more persons, whether natural or legal, who, until proven otherwise, constitute a single risk because:

(i) either one of them holds, directly or indirectly, power of control over the other or others, or

(ii) they are so interconnected that, if one of them were to experience financial problems, the other or all of them would be likely to encounter repayment difficulties. Such interconnections to be taken into consideration include in particular:

- common ownership;
- common directors;
- cross guarantees;
- direct commercial interdependence which cannot be substituted in the short term.

Article 2

Scope

Subject to paragraph 2, this Directive shall apply to credit institutions which have obtained the authorization referred to in Article 3 of Directive 77/780/EEC.

However, Member States need not apply this Directive to:

(a) credit institutions listed in Article 2(2) of Directive 77/780/EEC;

(b) institutions in the same Member State which, as defined in Article 2(4)(a) of Directive 77/780/EEC, are affiliated to a central body in that Member State. In that case, without prejudice to the application of this Directive to the central body, the whole - constituted by the central body and its affiliated institutions - must be the subject of global supervision with regard to large exposures.

Article 3

Reporting of large exposures

1. A report of every large exposure within the meaning of paragraph 2 shall be made by the credit institution to the competent authorities. Member States shall provide that this reporting is carried out at their discretion, in accordance with one of the following two methods:

   - notification of all large exposures at least once a year, backed up by communication during the year of any modifications to the annual notification;

   - notification of all large exposures at least four times a year.

2. An exposure of a credit institution to a client or group of connected clients is considered to be a "large exposure" where its value is equal to or exceeds 10% of own funds.

Article 4

Limits on large exposures

1. Credit institutions may not incur an exposure to a client or group of connected clients where its value exceeds 25% of own funds.

2. Where that client or group of connected clients is the parent undertaking of the credit institution and/or one or more subsidiaries of that parent undertaking, the percentage provided for in paragraph 1 shall be reduced to 20%.

3. Credit institutions may not incur large exposures which, in the aggregate, exceed 800% of own funds.

4. Member States may impose more stringent rules than those laid down in paragraphs 1, 2 and 3.

5. The limits referred to in paragraphs 1, 2 and 3 shall be observed at all times by the credit institution. They may be exceeded only in exceptional circumstances and, in such cases, the competent authorities shall fix a deadline within which the credit institution must regularize its situation.

6. Member States may fully or partially exempt from the application of paragraph 2 exposures incurred by the credit institution to a financial holding company which is its parent undertaking and to other subsidiaries of that financial holding company, provided that:

   a) the financial holding company is included in the supervision on a consolidated basis of the credit institution exercised in accordance with Directive .... (supervision on a consolidated basis);

b) those other subsidiaries are credit institutions, financial institutions or undertakings providing ancillary banking services and are included in the consolidated supervision of the credit institution exercised in accordance with Directive ..... (supervision on a consolidated basis).

7. Member States may fully or partially exempt from the application of paragraphs 1, 2 and 3 exposures incurred by the credit institution to:

a) its parent undertaking, provided that the parent undertaking is a credit institution subject to supervision on a consolidated basis exercised in accordance with Directive .... (supervision on a consolidated basis) or to equivalent standards in force in a third country;

b) subsidiaries, provided that those subsidiaries are credit institutions, financial institutions or undertakings providing ancillary banking services and are included in the consolidated supervision of the credit institution exercised in accordance with Directive .... (supervision on a consolidated basis).

8. Member States may fully or partially exempt the following exposures from the application of paragraphs 1, 2 and 3:

a) asset items constituting claims on Zone A central governments and central banks;

b) asset items constituting claims on the European Communities;

c) asset items constituting claims carrying the explicit guarantees of Zone A central governments and central banks or of the European Communities;

d) other exposures attributable to, or guaranteed by, Zone A central governments and central banks or the European Communities;

e) asset items which constitute claims on Zone B central governments and central banks, and which are denominated and funded in the national currencies of the borrowers;

f) asset items secured, to the satisfaction of the competent authorities, by collateral in the form of Zone A central government or central bank securities or securities issued by the European Communities;

g) asset items secured, to the satisfaction of the competent authorities, by collateral in the form of cash deposits placed with the lending institution or with a credit institution which is the parent undertaking of the lending institution;

h) asset items secured, to the satisfaction of the competent authorities, by collateral in the form of certificates of deposits issued by and lodged with the lending institution;

i) asset items constituting claims and other exposures on credit institutions, with a maturity of one year or less, but not constituting such institutions' own funds as defined in Directive 89/299/EEC;

j) bills of trade and other bills, with a maturity of one year or less, bearing the signature of another credit institution and accepted for refinancing by a central bank;

k) bonds defined in Article 22(4) of Council Directive 85/611/EEC[1];

1 OJ No L 375, 31.12.1985, p. 3.

l) asset items constituting claims on regional or central credit institutions with which the lending institution is associated as part of a network by virtue of legal or statutory provisions and which are responsible, in accordance with those provisions, for cash clearing operations within the network.

9. Member States may, for the purposes of paragraphs 1, 2 and 3, apply a weighting of 20% to asset items constituting claims on regional and local authorities in the Member States and to other exposures to such authorities or guaranteed by them; however, subject to the conditions laid down in Article 7 of Directive 89/647/EEC, Member States may reduce this rate to 0% .

10. Where an exposure to a client is guaranteed, to the satisfaction of the competent authorities, by a third party, Member States may deem the exposure to have been incurred to that third party and not to the client.

Article 5

Supervision on a consolidated or unconsolidated basis

1. If the credit institution is neither a parent undertaking nor a subsidiary, compliance with the obligations set out in Articles 3 and 4 shall be supervised on an unconsolidated basis.

2. If the credit institution is a parent undertaking, compliance with the obligations set out in Articles 3 and 4 shall be supervised on a consolidated basis in accordance with Directive ..... (supervision on a consolidated basis).

3. The competent authorities responsible for authorizing and supervising a credit institution which is a parent undertaking may also require the credit institution, together with any of its subsidiaries subject to authorization and supervision by them, to comply with the obligations set out in Articles 3 and 4 on a subconsolidated or unconsolidated basis. Where such monitoring of the satisfactory allocation of risks within a banking group is not carried out, other measures shall be taken to that end.

4. Where the subsidiary of a parent undertaking which is a credit institution has been authorized in another Member State, the competent authorities which granted that authorization shall require compliance with the obligations set out in Articles 3 and 4 on an unconsolidated basis or, if appropriate, subconsolidated.

5. Notwithstanding paragraph 4, the competent authorities responsible for authorizing the subsidiary of a parent undertaking situated in another Member State may, by way of a bilateral agreement, delegate responsibility for supervising compliance with the obligations set out in Articles 3 and 4 to the competent authorities which have authorized and which supervise the parent undertaking. The Commission and the Banking Advisory Committee shall be kept informed of the content of such agreements.

Article 6

Transitional provisions relating to exposures in excess of the limits

1. Where, at the time of the publication of this Directive in the Official Journal of the European Communities, a credit institution has already incurred an exposure or exposures exceeding either the large exposure limit or the aggregate large exposure limits, as referred to in Article 4, the competent authorities shall require the credit institution to take steps to have the exposure or exposures of the credit institutions concerned brought into line with the provisions of this Directive.

2. The process of having the exposure or exposures brought into line shall be devised, adopted, implemented and completed within the period deemed by the competent authorities to be consistent with the principle of sound administration and fair competition. The competent authorities shall inform the Commission and the Banking Advisory Committee of the schedule for the general process adopted.

3. Credit institutions may only take advantage of the period specified in paragraph 2 to the extent that it does not take any measure which would cause the exposures to exceed the level existing at the date of the publication of the Directive in the Official Journal of the European Communities.

4. The period applicable under paragraph 2 may not exceed five years as from 1 January 1993. However, loans with a longer maturity for which the lending credit institution is bound to respect the contractual terms, may be continued until their maturity.

5. For a period not exceeding five years starting from 1 January 1993, Member States may increase the limit laid down in Article 4(1) to 40% in the case of credit institutions belonging to the particular categories referred to in Article 4(2) of Directive 89/646/EEC. In such cases, the period referred to in paragraph 4 shall be reduced to three years and shall commence on expiry of the period referred to in this paragraph. The Member States concerned shall notify the Commission and the Banking Advisory Committee of the reasons which have led them to make use of this option and of the steps they have taken to bring the excess exposures into line with the limits laid down.

Article 7

Subsequent amendments

1. Technical amendments to the following points shall be adopted in accordance with the procedure set out in paragraph 2:

   - adaptation of definitions to take account of developments on financial markets;

   - clarification of definitions to ensure uniform application of this Directive;

   - alignment of the terminology and of the wording of the definitions on those contained in subsequent instruments concerning credit institutions and related matters;

   - the frequency referred to in Article 3(1);

   - clarification or extension of the exemptions provided for in Article 4(5) to (9);

   - the period referred to in Article 6(4).

2. The Commission shall be assisted by the committee provided for in the first subparagraph of Article 22(2) of Directive 89/646/EEC.

The representative of the Commission shall submit to the committee a draft of the measures to be taken. The committee shall deliver its opinion on the draft within a time limit which the chairman may lay down according to the urgency of the matter. The opinion shall be delivered by the majority laid down in Article 148(2) of the Treaty in the case of decisions which the Council is required to adopt on a proposal from the Commission. The votes of the representatives of the Member States within the committee shall be weighted in the mannner set out in that Article. The chairman shall not vote.

The Commission shall adopt the measures envisaged if they are in accordance with the opinion of the committee.

If the measures envisaged are not in accordance with the opinion of the committee, or if no opinion is delivered, the Commission shall, without delay, submit to the Council a proposal relating to the measures to be taken. The Council shall act by a qualified majority.

If, on the expiry of three months from the date of referral to the Council, the Council has not acted, the proposed measures shall be adopted by the Commission.

Article 8

Final provisions

1. Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with the provisions of this Directive on 1 January 1993. They shall forthwith inform the Commission thereof.

   When Member States adopt these provisions, these shall contain a reference to this Directive or shall be accompanied by such reference at the time of their official publication. The procedure for such reference shall be adopted by Member States.

2. Member States shall communicate to the Commission the texts of the main provisions of national law which they adopt in the field governed by this Directive.

Article 9

This Directive is addressed to the Member States.

Done at Brussels,

For the Council
The President

FINANCIAL STATEMENT

The proposal will not entail any costs for the European Communities' budget.

COMPETITIVENESS AND EMPLOYMENT IMPACT STATEMENT

I. What is the main reason for introducing the measure?

The main reason for introducing the measure is to improve and reinforce the supervision of credit institutions in the Community as regards risk concentration.

II. Features of the businesses in question

The proposal concerns credit institutions, i.e. a regulated category of enterprises.

Given the minimum initial capital and own funds amounts laid down in Articles 4 and 10 of Directive 89/646/EEC, it is doubtful whether there are many SMEs among the credit institutions concerned.

There is no regional concentration.

III. What direct obligations does this measure impose on businesses?

The proposal imposes on the enterprises concerned, namely credit institutions, the obligation to report their large exposures to the competent authorities and to limit those large exposures to a given proportion of their own funds (25% for an individual exposure, 800% for their aggregate large exposures).

IV. What indirect obligations are local authorities likely to impose on businesses?

No obligations are likely to be imposed by local authorities on the businesses concerned.

V. Are there any special measures in respect of SMEs?

The proposal seeks to improve the supervision of a regulated category of enterprise (credit institutions); it does not therefore involve SMEs in any way. Furthermore, as the proposal is designed to limit the large exposures of credit institutions, it is unlikely that it will have the effect of limiting the exposures incurred by credit institutions to SMEs.

VI. What is the likely effect on:

(a) the competitiveness of businesses?
(b) employment?

(a) As the proposal is designed to introduce fuller supervision of the activities of credit institutions, the danger of such institutions failing should be reduced, which can have only a beneficial impact on their performance and on the stability of economic and financial activity in general.

(b) No effect on employment is anticipated.

VII. Have employers' and employees' representatives been consulted? What are their views?

Employees' representatives were informed of the Commission's intention to draw up this proposal, which will have no impact on their situation.

As far as the business sector is concerned, informal consultations have been held with the Banking Federation of the European Community, the Savings Banks Group of the European Economic Community, the Association of Cooperative Banks of the EC and the European Community Mortgage Federation.

These trade associations generally accept the principle of legislation governing large exposures.

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