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## **Bank capital rules: General approach agreed ahead of talks with Parliament**

The Council today<sup>1</sup> unanimously agreed a general approach on two proposals - the so-called "CRD 4" package - amending the EU's rules on capital requirements for banks and investment firms, with a view to negotiations with the European Parliament.

The proposals set out to amend and replace the existing capital requirement directives<sup>2</sup> by two new legislative instruments: a *regulation* establishing prudential requirements that institutions need to respect and a *directive* governing access to deposit-taking activities.

They are aimed at transposing into EU law an international agreement approved by the G-20 in November 2010. The so-called Basel 3 agreement, concluded by the Basel Committee on Banking Supervision, strengthens bank capital requirements, introduces a mandatory capital conservation buffer and a discretionary countercyclical buffer, and foresees a framework for new regulatory requirements on liquidity and leverage.

The negotiations with the Parliament will aim for adoption of the package at first reading, if possible by June 2012.

The *regulation* would be directly applicable in order to prevent divergences in implementation at national level. The presidency's compromise text sets capital requirements and introduces initial liquidity requirements from 2013, according to national provisions, and a fully calibrated EU liquidity requirement from 2015<sup>3</sup>. To address longer term funding issues, the draft regulation calls on the Commission to submit by 31 December 2016 a report<sup>4</sup> and, if appropriate, a legislative proposal for a stable funding requirement.

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<sup>1</sup> The agreement was reached at a meeting of the Economic and Financial Affairs Council.  
<sup>2</sup> Directives 2006/48/EC and 2006/49/EC  
<sup>3</sup> to be introduced by delegated act on the basis of a recommendation by the Basel committee  
<sup>4</sup> based on an evaluation by the EBA

# **P R E S S**

The draft regulation also provides for the introduction of a leverage ratio from 1 January 2018, if agreed by Council and Parliament on the basis of a report to be presented by the Commission in 2016.

Specifically, the draft regulation would require banks and investment firms to hold common equity tier 1 (CET 1) capital of 4.5% of risk weighted assets, up from 2% applicable under current rules (4.5% from 2015 onwards; in 2013 within the range of 3.5% to 4.5%; and in 2014 within the range of 4% to 4.5%). The total capital requirement remains unchanged at 8%. The presidency's draft defines CET 1 capital instruments using 14 criteria, similar to those set out in Basel 3, and mandates the European Banking Authority (EBA) to monitor the quality of instruments issued by institutions.

Moreover, the draft regulation provides the opportunity for member states to impose, for up to two years (extendable), stricter prudential requirements for domestically authorised financial institutions (i.e. requirements on level of own funds, requirements for large exposures, public disclosure requirements, the level of the capital conservation buffer, liquidity requirements and risk weights for targeting asset bubbles in residential and commercial property). Such a decision by a national authority could only be overruled if, following a negative opinion by the EBA, the European Systemic Risk Board (ESRB) or the Commission, the Council votes by qualified majority against the measures. Member states would also be able to increase risk weights for residential and commercial property and intra financial sector exposures beyond those provided in the regulation and up to 25%.

The Commission, for its part, would also have the possibility to impose for one year stricter prudential requirements, via delegated acts addressed to all member states.

The draft *directive* introduces additional requirements for a capital conservation buffer of 2.5% CET 1 identical for all banks in the EU, and an institution-specific countercyclical capital buffer<sup>1</sup>, as well as the possibility for member states to introduce a systemic risk buffer of additional CET 1 capital for the financial sector or one or more subsets of it. Member states would be able to apply systemic risk buffers of up to 3% for all exposures and up to 5% for domestic and third country exposures, without having to seek prior Commission approval, while they could impose even higher buffers with prior Commission authorisation in the form of a delegated act. If a member state decides to impose a buffer of up to 3% for all exposures, the buffer has to be set equally on all exposures located within the EU.

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<sup>1</sup> National authorities would be responsible for setting countercyclical buffer rates within their jurisdictions, while financial institutions would have to set their buffer according on their credit exposure to the various jurisdictions.

The CRD 4 proposals also strengthen governance and supervision requirements, provide for supervisors to apply sanctions if EU rules are breached and seek to reduce reliance by credit institutions on external credit ratings by encouraging internal ratings based approaches or internal models.

Based respectively on articles 114 and 53(1) of the Treaty on the Functioning of the European Union, the regulation and the directive will require qualified majority for adoption by the Council, in agreement with the European Parliament.

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