

COMMISSION OF THE EUROPEAN COMMUNITIES

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Proposal for a

COUNCIL DIRECTIVE

on the supervision of credit institutions on a consolidated basis

(presented by the Commission to the Council)

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Proposal for a Council Directive
on the Supervision of Credit Institutions on a
Consolidated Basis

Explanatory Notes

I. General

The First Council Directive of 12th December 1977 on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions ⁽¹⁾, set out as an ultimate objective the overall supervision of a credit institution operating in several Member States by the competent authorities in the Member State where it has its head office. To this end it is necessary to progress towards a system whereby all credit institutions operating in the Community are subject to similar supervisory regimes. This proposal for a Directive requiring all Member States to supervise credit institutions on a consolidated basis is a step in this direction.

Although, as explained above, the origin of this proposal lies in the First Directive the timing of this particular proposal was affected by an initiative taken by the Central Bank Governors of the so-called Group of ten countries plus Switzerland. As a result of work done by the Basle Committee on Banking Regulations and Supervisory Practices the President of the Bank for International Settlements wrote, on behalf of the Central Bank Governors, to the supervisory authorities in the Group of ten plus Switzerland in June 1979, expressing his hope that all the countries would take steps to introduce supervision on a consolidated basis and that host authorities would be prepared to cooperate internationally so as to permit such consolidation. In response to this initiative the Commission put forward proposals for consideration by the Advisory Committee for Banking Coordination. This present proposal therefore takes account of the Advisory Committee's opinion on the form and content of a Directive on the supervision of credit institutions on a consolidated basis.

In preparing a proposal for a Directive the aim has been on the one hand to impose a legal obligation on Member States to supervise their credit institutions on a consolidated basis and on the other hand to keep the Directive as simple as possible in order to secure its rapid adoption. Accordingly the Directive now proposed should be seen as a first step only, concentrating on establishing the principle and leaving a good deal of discretion on the details to Member States. This said, however, it is felt that the proposal represents a desirable community response to the growing

(1) OJ. N° 322, 17.12.77, Doc. N° 77/780/EEC

international concensus in favour of prudential supervision on a consolidated basis.

Whilst it is desirable that there should be a measure of consistency between the requirements for consolidated accounting and those for consolidated supervision, it is not necessary for harmonisation of these two aspects of consolidation to be simultaneous. Supervisory authorities tend to rely more on prudential returns than on published accounts for their information and may wish to have a greater degree of flexibility in the treatment of minority interests than is necessary for consolidated accounts. This proposal, therefore, in no way impinges on the proposed seventh Directive on Group Accounts and does not pre-empt the subsequent coordination of consolidated accounts for credit institutions.

Four of the Member States, Italy, Luxembourg, Germany and Greece do not have any provision for consolidated supervision at present, although Italy and Germany are currently considering the possibility.

In Belgium and France the banking legislation allows for prudential measures to be calculated on a consolidated basis but this is not common practice at present.

In Denmark certain prudential ratios are calculated on a consolidated basis but this does not apply to the main solvency or liquidity ratios.

The remaining three Member States, Ireland, Netherlands and the United Kingdom already make extensive use of consolidated information for supervisory purposes.

The proposal contains eight articles :

Article 1 defines certain terms used in the Directive.

Article 2 defines the scope of the Directive and the provisions for deferred application

Article 3 establishes the principle of supervision on a consolidated basis and the procedures to be adopted.

Article 4 sets out the form and extent of consolidation required in particular circumstances.

Article 5 deals with the cross border flows of information which are necessary for consolidation to be effected.

Article 6 is concerned with the application of supervision on a consolidated basis to establishments of domestic institutions located outside the Community.

Articles 7 and 8 contain the final dispositions.

II. Commentary on the Articles

Article 1: Definitions

This article defines the terms used throughout the Directive. The definition of "credit institution" is taken from Directive 77/780/EEC (1). The definition of "financial institution" is intended to cover primarily those institutions who engage in business carrying a banking type risk but which do not fall within the definition of "credit institution" because they do not take deposits from the public.

"Participation" have been defined here to avoid a long explanatory phrase whenever the term used in the Directive.

The definition is not exactly the same as that used for "participating interest" in Directive 78/660/EEC (2). Although the same percentage is used in both cases it was not thought desirable to give Member States the power to set a lower percentage as is the case in Article 17 of Directive 78/660/EEC.

A very general definition of "supervision" is used in order to give the competent authorities a degree of flexibility which is necessary pending subsequent coordination of supervisory techniques.

(1) O.J. N° L 322 17 December 1977

(2) O.J. N° L 222 14 August 1978

Article 2 : Scope of Application

This Article states that the Directive will apply to all credit institutions except those exempt from the provisions of Directive 77/780/EEC and specifically listed in this article. It is important not to confuse the scope of the Directive with the scope of consolidation. Thus although it is proposed that only groups headed by a credit institution should be subject to this Directive, it is envisaged that consolidation of such groups will embrace not only credit institutions but also financial institutions within the group which contribute to the banking activities of the group; these will mainly be institutions with financial assets which fall outside the definition of credit institution because they do not take deposits from the public.

Article 3: General Principles

This Article sets out the main aim of the proposal - Supervision of Credit institutions on the basis of their consolidation with other credit or financial institutions within the group.

It should be noted that consolidation is only required where a participation is held by a credit institution. If a number of credit institutions are owned directly by a financial institution or any other type of body the provisions of this Directive will not apply. Indirect holdings of credit institutions are, however, covered, so that the provisions of the proposal cannot be avoided by inserting a holding company between two credit institutions.

The exceptions listed in paragraph 1 are designed to deal with situations where consolidation is either not possible or not necessary from a supervisory point of view.

In the absence of coordinated consolidated accounts and prudential returns it is not possible to aim for entirely consistent methods of consolidation in all Member States. Paragraph 2 of this Article, therefore, provides for national procedures to be used pending further coordination.

This Article also specifies that consolidated supervision shall be exercised by the supervisory authorities of the country where the head office of the credit institution is situated.

To avoid any possible misunderstanding, paragraph 4 of this Article specifically states that the proposal does not affect the present practices of Member States with regard to supervision on an unconsolidated basis; so that a subsidiary of a credit institution whose parent is in another Member State may find that it is still supervised by the host supervisory authority on an unconsolidated basis as well as providing information to its parent for the purpose of consolidated supervision.

Article 4 : Form and extent of consolidation

The proposal distinguishes between situations where a credit institution owns the majority of the capital of another credit or financial institution and those where only a minority of the capital is owned.

In majority situations the competent authorities of the parent credit institution can choose between full or pro rata consolidation. It is necessary to leave the choice to the supervisory authorities because in certain cases a bank's moral responsibility for another credit institution in which it has a participation might be considered to extend beyond its equity share especially where it is the largest single shareholder and even more so if the other shareholders are non-banks. In such cases full consolidation would normally be appropriate. However, in cases where, for example, the other shareholders were also banks, pro rata consolidation might be deemed appropriate.

For minority participations, where a situation of effective control exists consolidation will normally be required, with the method of consolidation being left entirely to the discretion of the competent authorities of the parent institution. However, pending further coordination on the treatment of minority interests it was felt necessary to provide for consolidation to be avoided in cases where both the competent authorities of the parent institution and those of the institution in which the participation is held agree that it is not necessary.

In all other cases of minority participations the question of whether consolidation should take place or not is left to the discretion of the competent authorities of the parent institution.

The treatment of minority interests in this Article is important because of the implication it holds for Article 5 where the obligation on Member States to allow the necessary flow of information is restricted to that which is "necessary for the implementation of this "Directive". The relationship between these two articles is such that a requirement to consolidated, automatically gives the right to the necessary information.

Article 5: Facilitating measures

This Article deals with the exchange of information, between a parent credit institution and its subsidiaries, and between the competent authorities of the Member States, which is necessary for the authorities of the parent company to be able to supervise on a consolidated basis. It can, of course, only legislate for flows of information between Member States; the exchange of information with third countries is dealt with in Article 6.

It is envisaged that principle flow of information for consolidation purposes will be between a subsidiary company and its parent. Direct exchange of statistical information between supervisory authorities would only take place in exceptional circumstances.

The proposal does not contain any provisions concerning the direct inspection of credit institutions situated in other Member States by the supervisory authority of a parent credit institution. It does however give the supervisory authorities concerned the right to appoint a local firm of auditors to verify the information it has received. There is nevertheless a presumption that if necessary inspection rights could be obtained by way of bilateral agreements.

Article 6 : Third Countries

As Community legislation cannot be applied to parent institutions situated in third countries or credit institutions in third countries whose parent company is within the Community, this Article provides for bilateral agreements between the Member States and third countries to facilitate the flow of information necessary for consolidation to be effected. The objective being to allow supervisory authorities in the Member States to supervise parent credit institutions on the basis of their world wide operations and supervisory authorities in third countries to include where appropriate credit institutions situated in the Community in the consolidation of their banks.

The Commission is charged with a coordinating rôle only at this stage but it is hoped that eventually these bilateral agreements can be replaced by agreements between the Community and third countries.

Proposal for a Council Directive

on the supervision of credit institutions on a consolidated basis

THE COUNCIL OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community and in particular Article 57 thereof,

Having regard to the proposal from the Commission,

Having regard to the opinion of the European Parliament,

Having regard to the opinion of the Economic and Social Committee,

Whereas the First Council Directive 77/780/EEC of 12 December 1977 on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions¹ states that, in order to make it easier to take up and pursue the business of credit institutions, it is necessary to eliminate the most obstructive differences between the laws of the Member States as regards the rules to which these institutions are subject ;

Whereas the eventual aim is to provide for overall supervision of a credit institution operating in several Member States by the competent authorities in the Member State where it has its head office, in consultation as appropriate with the competent authorities of the other Member States concerned, in such a way that distortions of competition are avoided between the credit institutions and the domestic credit institutions of their host countries; whereas to that end controls and supervisory practices applied to credit institutions operating within the Community must be broadly similar from one Member State to another;

Whereas this objective can only be attained by stages; whereas the establishment of the principle of supervision on a consolidated basis is one such stage;

1) O.J. N° L 322, 17.12.77, p.30

Whereas supervision on a consolidated basis should enable the supervisory authority of a parent credit institution to make a more considered judgment about the financial situation of that credit institution;

Whereas this Directive is concerned solely with ownership, partial or complete, of one credit or financial institution by another credit institution;

Whereas the principle of supervision on a consolidated basis is broadly accepted, whereas Member States will therefore seek to conclude bilateral agreements with non-member countries designed to ensure that credit institutions in such countries with holdings in the Community are subject to equivalent supervision and that credit institutions from the Community with holdings outside the Community are able to apply the principles laid down in this Directive without the flow of information being hindered;

Whereas, pending coordination of consolidated accounts and prudential returns it is not possible to implement consolidated supervision on a consistent basis in all Member States; whereas this Directive represents an interim measure designed to establish the principle of supervision on a consolidated basis and to eliminate the obstacles which have hitherto prevented Member States from implementing the principle on a unilateral basis;

Whereas, pending further coordination the process of consolidation is to be undertaken by Member States according to their national procedures;

Whereas the provisions of this Directive do not preclude supervision of individual credit institutions by the competent authorities of the host Member State;

Whereas although financial institutions as defined hereinafter are not subject to either Directive 77/780/EEC or this Directive their inclusion in the consolidation procedure is necessary in order to ensure complete consolidation of all the appropriate activities within a group;

Whereas this Directive does not contain any provisions concerning the rights of the supervisory authorities of a parent company to inspect credit institutions in which the parent company has a participation, which are situated in another Member State; the Member States will presume that they can obtain such rights by way of bilateral agreements; whereas as a transitional measure supervisory authorities will be able to appoint auditors to verify information received from credit institutions in another Member State,

HAS ADOPTED THIS DIRECTIVE :

Article 1 : Definitions

For the purposes of this Directive:

- "credit institution" means, in accordance with the first indent of Article 1 of Directive 77/780/EEC, an undertaking whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account;
 - "financial institution" means an undertaking, not being a credit institution, whose principal activity is to grant credit facilities (including guarantees), to acquire participations or to make investments;
 - "participation" means the ownership by a credit institution, whether directly or indirectly, of 20 % or more of the capital of another credit or financial institution;
 - "supervision" pending subsequent coordination, means the techniques, in whatever form and however implemented, employed by the competent authorities in each Member State in order to monitor prudential aspects of a credit institution's business.
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Article 2 : Scope

1. Subject to Article 3 (1), this Directive shall apply to all credit institutions.
2. The institutions exempted from the provisions of Directive 77/780/EEC and listed in Article 2 thereof shall be exempted from the provisions of this Directive.
3. Member States may defer the application of this Directive to certain institutions. Such deferment shall be on the terms set out in Article 2 (5) and (6) of Directive 77/780/EEC.

Article 3 : General Principles

1. Any credit institution which holds a participation in another credit or financial institution shall be subject, to the extent and in the manner required by Article 4, to supervision on the basis of the consolidation of its financial situation with that of the institution in which it holds such participation, unless:
 - the activities of the credit institution holding the participation are at least 80 % consolidated with another credit institution which is subject to supervision on a consolidated basis by the competent authorities of one of the Member States and the credit institution in which the participation is held is, without prejudice to the following indents, included in this supervision on a consolidated basis; or
 - the credit or financial institution in which the participation is held is situated in a non-member country where there are legal impediments to the transfer of the necessary information; or
 - the participation represents less than 2 % of the capital and reserves of the credit institution which holds the participation or less than 500,000 E.C.U., whichever is the lesser amount; or
 - the nature of the business of the credit or financial institution in which the participation is held is such that, in the opinion of the competent authorities for the credit institution which holds the participation, consolidation would be inappropriate or misleading.
2. Pending subsequent coordination, and except as otherwise provided in this Directive, the process of consolidation shall be undertaken according to the national procedures applicable to the credit institution which holds the participation.
3. Supervision on a consolidated basis shall be exercised by the competent authorities of the country in which the credit institution which holds the participation has its head office.
4. Such supervision shall take place at least once a year and shall be without prejudice to supervision on an unconsolidated basis and without prejudice to supervision carried out by the competent authorities in other Member States.

Article 4 : Form and extent of consolidation

1. Where a credit institution holds a participation of more than 50% in another credit or financial institution, the competent authorities for that credit institution shall require either full or pro rata consolidation of the institutions concerned.
2. Where a credit institution holds a participation of 50 % or less in/and, in the opinion of the competent authorities for that credit institution, a situation of effective control exists, it shall be a matter for the discretion of those competent authorities how consolidation should be effected. Pending further coordination, however, the competent authorities in the Member State in which the credit institution has its head office and the competent authorities for the credit or financial institution in which the participation is held may agree that consolidation of such a holding is not required in given cases.
3. Where a credit institution holds a participation of 50 % or less in another credit or financial institution and a situation of effective control does not exist, it shall be a matter for the discretion of the competent authorities for that credit institution whether and how consolidation is to be effected.

Article 5 : Facilitating Measures

1. Member States shall ensure that there are no legal impediments such as to prevent any credit or financial institution supplying to a credit institution which has a participation therein information which is necessary for supervision on a consolidated basis to be effected in accordance with this Directive.
2. Member States shall permit the exchange between their competent authorities of the information necessary for supervision on a consolidated basis to be effected in accordance with this Directive, it being understood that, in the case of financial institutions, the collection of information shall in no way imply a supervisory function over such financial institutions by those competent authorities.
3. Any exchange of information between competent authorities provided for in this Directive shall be subject to the obligation of professional secrecy as set out in Article 12 of Directive 77/780/EEC and any such information shall be used exclusively for the purposes of supervision on a consolidated basis as required by this Directive.
4. If, in applying the provisions of this Directive to a credit institution, the competent authorities in one Member State wish to verify the information received from a credit or financial institution in another Member State they may appoint an auditor, approved for this purpose by the competent authorities of the other Member State concerned, to undertake such verification.

Article 6: Non-member countries

1. The application of the principle of supervision on a consolidated basis to Community credit institutions, the parent institutions of which have their head offices in non-member countries, and to credit institutions situated outside the Community whose parent institutions are situated within the Community shall be a matter for bilateral arrangements, on the basis of reciprocity, between the competent authorities of the Member States and the non-member countries concerned. Such arrangements shall seek to ensure that Member States' competent authorities are able to obtain the necessary information to enable a credit institution within the Community, with participations in credit or financial institutions outside the Community, to be supervised on a consolidated basis, and that supervisory authorities in non-member countries are able to obtain the information necessary to supervise parent institutions having head offices within their territory which have participations in credit institutions in one or more Member States.

2. The Commission and the Advisory Committee set up under Article 11 of Directive 77/780/EEC shall be kept informed of such steps as may be taken in this context and the Commission shall undertake the coordination of the arrangements referred to in paragraph 1.

Final Provisions

Article 7

1. Member States shall bring into force the measures necessary to comply with this Directive not later than and shall forthwith inform the Commission thereof.
2. The Member States shall communicate to the Commission the texts of the main laws, regulations and administrative provisions which they adopt in the field covered by this Directive.

Article 8

This Directive is addressed to the Member States.