DIRECTIVES

DIRECTIVE 2010/76/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

of 24 November 2010

amending Directives 2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for re-securitisations, and the supervisory review of remuneration policies

(Text with EEA relevance)

THE EUROPEAN PARLIAMENT AND THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 53(1) thereof,

Having regard to the proposal from the European Commission,

Having regard to the opinion of the European Central Bank [1],

Having regard to the opinion of the European Economic and Social Committee [2],

Acting in accordance with the ordinary legislative procedure [3],

Whereas:

(1) Excessive and imprudent risk-taking in the banking sector has led to the failure of individual financial institutions and systemic problems in Member States and globally. While the causes of such risk-taking are many and complex, there is agreement by supervisors and regulatory bodies, including the G-20 and the Committee of European Banking Supervisors (CEBS), that the inappropriate remuneration structures of some financial institutions have been a contributory factor. Remuneration policies which give incentives to take risks that exceed the general level of risk tolerated by the institution can undermine sound and effective risk management and exacerbate excessive risk-taking behaviour. The internationally agreed and endorsed Financial Stability Board (FSB) Principles for Sound Compensation Practices (the FSB principles) are therefore of particular importance.

(2) Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions [4] requires credit institutions to have arrangements, strategies, processes and mechanisms to manage the risks to which they are exposed. By virtue of Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions [5], that requirement applies to investment firms within the meaning of Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments [6]. Directive 2006/48/EC requires competent authorities to review those arrangements, strategies, processes and mechanisms, and to determine whether the own funds held by the credit institution or investment firm concerned ensure a sound management and coverage of the risks to which the institution or firm is or might be exposed. That supervision is carried out on a consolidated basis in relation to banking groups, and includes financial holding companies and affiliated financial institutions in all jurisdictions.

(3) In order to address the potentially detrimental effect of poorly designed remuneration structures on the sound management of risk and control of risk-taking behaviour by individuals, the requirements of Directive 2006/48/EC should be supplemented by an express obligation for credit institutions and investment firms to establish and maintain, for categories of staff whose professional activities have a material impact on their risk profile, remuneration policies and practices that are consistent with effective risk management. Those categories of staff should include at least senior management, risk takers, staff engaged in control functions and any employee whose total remuneration, including discretionary pension benefit provisions, takes them into the same remuneration bracket as senior management and risk takers.

(4) Because excessive and imprudent risk-taking may undermine the financial soundness of credit institutions or investment firms and destabilise the banking system, it is important that the new obligation concerning remuneration policies and practices should be implemented in a

[1] OJ C 291, 1.12.2009, p. 1.
[2] Opinion of 20 January 2010 (not yet published in the Official Journal).
[3] Position of the European Parliament of 7 July 2010 (not yet published in the Official Journal) and decision of the Council of 11 October 2010.
[4] OJ L 177, 30.6.2006, p. 1.
[5] OJ L 177, 30.6.2006, p. 201.
[6] OJ L 145, 30.4.2004, p. 1.

consistent manner and should cover all aspects of remuneration including salaries, discretionary pension benefits and any similar benefits. In that context, discretionary pension benefits should mean discretionary payments granted by a credit institution or investment firm to an employee on an individual basis payable by reference to or expectation of retirement and which can be assimilated to variable remuneration. It is therefore appropriate to specify clear principles on sound remuneration to ensure that the structure of remuneration does not encourage excessive risk-taking by individuals or moral hazard and is aligned with the risk appetite, values and long-term interests of the credit institution or investment firm. Remuneration should be aligned with the role of the financial sector as the mechanism through which financial resources are efficiently allocated in the economy. In particular, the principles should provide that the design of variable remunerationpolicies ensures that incentives are aligned with the long-term interests of the credit institution or investment firm and that payment methods strengthen its capital base. Performance-based components of remuneration should also help enhance fairness within the remuneration structures of the credit institution or investment firm. The principles should recognise that credit institutions and investment firms may apply the provisions in different ways according to their size, internal organisation and the nature, scope and complexity of their activities and, in particular, that it may not be proportionate for investment firms referred to in Article 20(2) and (3) of Directive 2006/49/EC to comply with all of the principles. In order to ensure that the design of remuneration policies is integrated in the risk management of the credit institution or investment firm, the management body, in its supervisory function, of each credit institution or investment firm should adopt and periodically review the principles to be applied. In that context, it should be possible, where applicable and in accordance with national company law, for the management body in its supervisory function to be understood as the supervisory board.

(5) Credit institutions and investment firms that are significant in terms of their size, internal organisation and the nature, the scope and the complexity of their activities should be required to establish a remuneration committee as an integral part of their governance structure and organisation.

(6) By 1 April 2013, the Commission should review the principles on remuneration policy with particular regard to their efficiency, implementation and enforcement, taking into account international developments including any further proposals from the FSB and the implementation of the FSB principles in other jurisdictions including the link between the design of variable remuneration and excessive risk-taking behaviour.

(7) Remuneration policy should aim at aligning the personal objectives of staff members with the long-term interests of the credit institution or investment firm concerned. The assessment of the performance-based components of remuneration should be based on longer-term performance and take into account the outstanding risks associated with the performance. The assessment of performance should be set in a multi-year framework of at least three to 5 years, in order to ensure that the assessment process is based on longer term performance and that the actual payment of performance-based components of remuneration is spread over the business cycle of the credit institution or investment firm. To align incentives further, a substantial portion of variable remuneration of all staff members covered by those requirements should consist of shares, share-linked instruments of the credit institution or investment firm, subject to the legal structure of the credit institution or investment firm concerned or, in the case of a non-listed credit institution or investment firm, other equivalent non-cash instruments and, where appropriate, other long-dated financial instruments that adequately reflect the credit quality of the credit institution or investment firm. It should be possible for such instruments to include a capital instrument which, where the institution is subject to severe financial problems, is converted into equity or otherwise written down. In cases where the credit institution concerned does not issue long-dated financial instruments, it should be permitted to issue the substantial portion of variable remuneration in shares and share-linked instruments and other equivalent non-cash instruments. The Member States or their competent authorities should be able to place restrictions on the types and designs of those instruments or prohibit certain instruments, as appropriate.

(8) To minimise incentives for excessive risk-taking, variable remuneration should constitute a balanced proportion of total remuneration. It is essential that an employee's fixed salary represents a sufficiently high proportion of his total remuneration to allow the operation of a fully flexible variable remuneration policy, including the possibility to pay no variable remuneration. In order to ensure coherent remuneration practices throughout the sector, it is appropriate to specify certain clear requirements. Guaranteed variable remuneration is not consistent with sound risk management or the pay-for-performance principle and should, as a general rule, be prohibited.

(9) A substantial portion of the variable remuneration component, such as 40 to 60 %, should be deferred over an appropriate period of time. That portion should increase significantly with the level of seniority or responsibility of the person remunerated. Moreover, a substantial portion of the variable remuneration component should consist of shares, share-linked instruments of the credit institution or investment firm,

subject to the legal structure of the credit institution or investment firm concerned or, in the case of a non-listed credit institution or investment firm, other equivalent non-cash instruments and, where appropriate, other long-dated financial instruments that adequately reflect the credit quality of the credit institution or investment firm. In that context, the principle of proportionality is of great importance since it may not always be appropriate to apply those requirements in the context of small credit institutions and investment firms. Taking into account the restrictions that limit the amount of variable remuneration payable in cash and payable upfront, the amount of variable remuneration which can be paid in cash or cash equivalent not subject to deferral should be limited in order to further align the personal objectives of staff with the long-term interest of the credit institution or investment firm.

(10) Credit institutions and investment firms should ensure that the total variable remuneration does not limit their ability to strengthen their capital base. The extent to which capital needs to be built up should be a function of the current capital position of the credit institution or investment firm. In that context, Member States' competent authorities should have the power to limit variable remuneration, inter alia, as a percentage of total net revenue when it is inconsistent with the maintenance of a sound capital base.

(11) Credit institutions and investment firms should require their staff to undertake not to use personal hedging strategies or insurance to undermine the risk alignment effects embedded in their remuneration arrangements.

(12) Regarding entities that benefit from exceptional government intervention, priority should be given to building up their capital base and providing for recovery of taxpayer assistance. Any variable remuneration payments should reflect those priorities.

(13) The principles regarding sound remuneration policies set out in the Commission Recommendation of 30 April 2009 on remuneration policies in the financial services sector [1] are consistent with and complement the principles set out in this Directive.

(14) The provisions on remuneration should be without prejudice to the full exercise of fundamental rights guaranteed by the Treaties, in particular Article 153(5) of the Treaty on the Functioning of the European Union (TFEU), general principles of national contract and labour law, legislation regarding shareholders' rights and involvement and the general responsibilities of the administrative and supervisory bodies of the institution concerned, as well as the rights, where applicable, of the social partners to conclude and enforce collective agreements, in accordance with national law and customs.

(15) In order to ensure fast and effective enforcement, the competent authorities should also have the power to impose or apply financial or non-financial penalties or other measures for breach of a requirement under Directive 2006/48/EC, including the requirement to have remuneration policies that are consistent with sound and effective risk management. Those measures and penalties should be effective, proportionate and dissuasive. In order to ensure consistency and a level playing field, the Commission should review the adoption and application by the Member States of such measures and penalties on an aggregate basis with regard to their consistency across the Union.

(16) In order to ensure effective supervisory oversight of the risks posed by inappropriate remuneration structures, the remuneration polices and practices adopted by credit institutions and investment firms should be included in the scope of supervisory review under Directive 2006/48/EC. In the course of that review, supervisors should assess whether those policies and practices are likely to encourage excessive risk-taking by the staff in question. In addition, CEBS should ensure the existence of guidelines for the assessment of the suitability of the persons who effectively direct the business of a credit institution.

(17) The Commission Green Paper of 2 June 2010 on corporate governance in financial institutions and remuneration policies identifies a series of failures in corporate governance in credit institutions and investment firms that should be addressed. Among the solutions identified, the Commission refers to the need to strengthen significantly requirements relating to persons who effectively direct the business of the credit institution who should be of sufficiently good repute and have appropriate experience and also be assessed as to their suitability to perform their professional activities. The Green Paper also underlines the need to improve shareholders' involvement in approving remuneration policies. The European Parliament and the Council note the Commission's intention, as a follow-up, to make legislative proposals, where appropriate, on those issues.

(18) In order further to enhance transparency as regards the remuneration practices of credit institutions and investment firms, the competent authorities of Member States should collect information on remuneration to benchmark remuneration trends in accordance with the categories of quantitative information that the credit institutions and investment firms are required to disclose under this Directive. The competent authorities should provide CEBS with that information in order to enable it to conduct similar assessments at Union level.

[1] OJ L 120, 15.5.2009, p. 22.

(19) In order to promote supervisory convergences in the assessment of remuneration policies and practices, and to facilitate information collection and the consistent implementation of the remuneration principles in the banking sector, CEBS should elaborate guidelines on sound remuneration policies in the banking sector. The Committee of European Securities Regulators should assist in the elaboration of such guidelines to the extent that they also apply to remuneration policies for persons involved in the provision of investment services and carrying out of investment activities by credit institutions and investment firms within the meaning of Directive 2004/39/EC. CEBS should conduct open public consultations regarding the technical standards and analyse the potentially related costs and benefits. The Commission should be able to make legislative proposals entrusting the European supervisory authority dealing with banking matters and, to the extent it is appropriate, the European supervisory authority dealing with markets and securities matters, as established pursuant to the *de Larosière* process on financial supervision, with the elaboration of draft technical regulatory and implementing standards to facilitate information collection and the consistent implementation of the remuneration principles in the banking sector to be adopted by the Commission.

(20) Since poorly designed remuneration policies and incentive schemes are capable of increasing to an unacceptable extent the risks to which credit institutions and investment firms are exposed, prompt remedial action and, if necessary, appropriate corrective measures should be taken. Consequently, it is appropriate to ensure that competent authorities have the power to impose qualitative or quantitative measures on the relevant entities that are designed to address problems that have been identified in relation to remuneration policies in the Pillar 2 supervisory review. Qualitative measures available to the competent authorities include requiring the credit institutions and investment firms to reduce the risk inherent in their activities, products or systems, including by introducing changes to their structures of remuneration or freezing the variable parts of remuneration to the extent that they are inconsistent with effective risk management. Quantitative measures include a requirement to hold additional own funds.

(21) Good governance structures, transparency and disclosure are essential for sound remuneration policies. In order to ensure adequate transparency to the market of their remuneration structures and the associated risk, credit institutions and investments firms should disclose detailed information on their remuneration policies, practices and, for reasons of confidentiality, aggregated amounts for those members of staff whose professional activities have a material impact on the risk profile of the credit institution or investment firm. That information should be made available to all stakeholders (shareholders, employees and the general public). However, that obligation should be without prejudice to Directive 95/46/EC of the European Parliament and of the Council of 24 October 1995 on the protection of individuals with the regard to the processing of personal data and on the free movement of such data [1].

(22) In order to guarantee their full effectiveness and in order to avoid any discriminatory effect in their application, the provisions on remuneration laid down in this Directive should be applied to remuneration due on the basis of contracts concluded before the date of their effective implementation in each Member State and awarded or paid after that date. Moreover, in order to safeguard the objectives pursued by this Directive, especially effective risk management, in respect of periods still characterised by a high degree of financial instability, and in order to avoid any risk of circumvention of the provisions on remuneration laid down in this Directive during the period prior to their implementation, it is necessary to apply those provisions to remuneration awarded, but not yet paid, before the date of their effective implementation in each Member State, for services provided in 2010.

(23) The review of risks to which the credit institution might be exposed should result in effective supervisory measures. It is therefore necessary that further convergence be reached with a view to supporting joint decisions by supervisors and ensuring equal conditions of competition within the Union.

(24) Credit institutions investing in re-securitisations are required under Directive 2006/48/EC to exercise due diligence also with regard to the underlying securitisations and the non-securitisation exposures ultimately underlying the former. Credit institutions should assess whether exposures in the context of asset-backed commercial paper programmes constitute re-securitisation exposures, including those in the context of programmes which acquire senior tranches of separate pools of whole loans where none of those loans is a securitisation or re-securitisation exposure, and where the first-loss protection for each investment is provided by the seller of the loans. In the latter situation, a pool-specific liquidity facility should generally not be considered a re-securitisation exposure because it represents a tranche of a single asset pool (that is, the applicable pool of whole loans) which contains no securitisation exposures. By contrast, a programme-wide credit enhancement covering only some of the losses above the seller-provided protection across the various pools generally would constitute a tranching of the risk of a pool of multiple assets containing at least one securitisation exposure, and would therefore be a re-securitisation exposure. Nevertheless, if such a programme funds

[1] OJ L 281, 23.11.1995, p. 31.

itself entirely with a single class of commercial paper, and if either the programme-wide credit enhancement is not a re-securitisation or the commercial paper is fully supported by the sponsoring credit institution, leaving the commercial paper investor effectively exposed to the default risk of the sponsor instead of the underlying pools or assets, then that commercial paper generally should not be considered a re-securitisation exposure.

(25) The provisions on prudent valuation in Directive 2006/49/EC should apply to all instruments measured at fair value, whether in the trading book or non-trading book of institutions. It should be clarified that, where the application of prudent valuation would lead to a lower carrying value than actually recognised in the accounting, the absolute value of the difference should be deducted from own funds.

(26) Institutions should have a choice whether to apply a capital requirement to or deduct from own funds those securitisation positions that receive a 1 250 % risk weight under this Directive, irrespective of whether the positions are in the trading or the non-trading book.

(27) Capital requirements for settlement risks should also apply to the non-trading book.

(28) Originator or sponsor institutions should not be able to circumvent the prohibition of implicit support by using their trading books in order to provide such support.

(29) Without prejudice to the disclosures explicitly required by this Directive, the aim of the disclosure requirements should be to provide market participants with accurate and comprehensive information regarding the risk profile of individual institutions. Institutions should therefore be required to disclose additional information not explicitly listed in this Directive where such disclosure is necessary to meet that aim.

(30) In order to ensure coherent implementation of Directive 2006/48/EC throughout the Union, the Commission and CEBS set up a working group (Capital Requirements Directive Transposition Group – CRDTG) in 2006, entrusted with the task of discussing and resolving issues related to the implementation of that Directive. According to the CRDTG, certain technical provisions of Directives 2006/48/EC and 2006/49/EC need to be further specified. It is therefore appropriate to specify those provisions.

(31) Where an external credit assessment for a securitisation position incorporates the effect of credit protection provided by the investing institution itself, the institution should not be able to benefit from the lower risk weight resulting from that protection. This should not lead to the deduction from capital of the securitisation if there are other ways to determine a risk weight in line with the actual risk of the position, not taking into account such credit protection.

(32) In the field of securitisation, disclosure requirements of institutions should be considerably strengthened. They should in particular also take into account the risks of securitisation positions in the trading book. Furthermore, in order to ensure adequate transparency regarding the nature of an institution's securitisation activities, disclosures should reflect the extent to which the institution sponsors securitisation special purpose entities and the involvement of certain affiliated entities, since closely related parties may pose on-going risks to the institution concerned.

(33) Specific risk charges for securitisation positions should be aligned with the capital requirements in the banking book since the latter provide for a more differentiated and risk-sensitive treatment of securitisation positions.

(34) Given their recent weak performance, the standards for internal models to calculate market risk capital requirements should be strengthened. In particular, their capture of risks should be completed regarding credit risks in the trading book. Furthermore, capital charges should include a component adequate to stress conditions to strengthen capital requirements in view of deteriorating market conditions and in order to reduce the potential for pro-cyclicality. Institutions should also carry out reverse stress tests to examine what scenarios could challenge the viability of the institution unless they can prove that such a test is dispensable. Given the recent particular difficulties of treating securitisation positions using approaches based on internal models, institutions' ability to model securitisation risks in the trading book should be limited and a standardised capital charge for securitisation positions in the trading book should be required by default.

(35) This Directive lays down limited exceptions for certain correlation trading activities, in accordance with which an institution may be permitted by its supervisor to calculate a comprehensive risk capital charge subject to strict minimum requirements. In such cases the institution should be required to subject those activities to a capital charge equal to the higher of the capital charge in accordance with that internally developed approach and 8 % of the capital charge for specific risk in accordance with the standardised measurement method.

It should not be required to subject those exposures to the incremental risk charge but they should be incorporated into both the value-at-risk measures and the stressed value-at-risk measures.

(36) Article 152 of Directive 2006/48/EC requires certain credit institutions to provide own funds that are at least equal to certain specified minimum amounts for the three twelve-month periods between 31 December 2006 and 31 December 2009. In the light of the current situation in the banking sector and the extension of the transitional arrangements for minimum capital adopted by the Basel Committee on Banking Supervision, it is appropriate to renew that requirement for a limited period of time until 31 December 2011.

(37) In order not to discourage credit institutions from moving to the Internal Ratings Based Approach (the IRB Approach) or Advanced Measurement Approaches for calculating the capital requirements during the transitional period due to unreasonable and disproportionate implementation costs, it should be possible to allow credit institutions which have moved to the IRB Approach or Advanced Measurement Approaches since 1 January 2010 and which have previously calculated their capital requirements in accordance with other less sophisticated approaches, subject to supervisory approval, to use the less sophisticated approaches as the basis for the calculation of the transitional floor. The competent authorities should monitor their markets closely and ensure a level playing field within all their markets and market segments and avoid distortions in the internal market.

(38) In accordance with point 34 of the Interinstitutional Agreement on better law-making [1], Member States are encouraged to draw up, for themselves and in the interest of the Union, their own tables illustrating, as far as possible, the correlation between this Directive and the transposition measures, and to make them public.

(39) The provisions of this Directive constitute steps in the reform process in response to the financial crisis. In line with the conclusions of the G-20, the FSB and the Basel Committee on Banking Supervision, further reforms may be necessary, including the need to build counter-cyclical buffers, 'dynamic provisioning', the rationale underlying the calculation of capital requirements in Directive 2006/48/EC and supplementary measures to risk-based requirements for credit institutions to help constrain the build-up of leverage in the banking system. In order to ensure appropriate democratic oversight of the process, the European Parliament and the Council should be involved in a timely and effective manner.

(40) The Commission should review the application of Directives 2006/48/EC and 2006/49/EC to ensure that their provisions are applied in an equitable way which does not result in discrimination between credit institutions on the basis of their legal structure or ownership model.

(41) The Commission should be empowered to adopt delegated acts in accordance with Article 290 TFEU in respect of technical adjustments to Directive 2006/48/EC to clarify definitions to ensure uniform application of that Directive or to take account of developments on financial markets; to align terminology on, and frame definitions in accordance with, subsequent relevant acts; to expand the content or adapt the terminology of the list of activities subject to mutual recognition under that Directive to take account of developments on financial markets; to adjust the areas in which the competent authorities are required to exchange information; to adjust the provisions of that Directive on own funds to reflect developments in accounting standards or Union legislation, or with regard to the convergence of supervisory practices; to expand the lists of exposure classes for the purposes of the Standardised Approach or the IRB Approach to take account of developments on financial markets; to adjust certain amounts relevant to those exposure classes to take into account the effects of inflation; to adjust the list and classification of off-balance sheet items; and to adjust specific provisions and technical criteria on the treatment of counterparty credit risk, the organisation and treatment of risk, the Standardised Approach and the IRB Approach, credit risk mitigation, securitisation, operational risk, review and evaluation by the competent authorities and disclosure in order to take account of developments on financial markets or in accounting standards or Union legislation, or with regard to the convergence of supervisory practices. The Commission should also be empowered to adopt delegated acts in accordance withArticle 290 TFEU in respect of measures to specify the size of sudden and unexpected changes in interest rates relevant for the purposes of the review and evaluation by the competent authorities under Directive 2006/48/EC of interest rate risk arising from non-trading activities; to prescribe a temporary reduction in the minimum level of own funds or risk weights specified under that Directive in order to take account of specific circumstances; to clarify the exemption of certain exposures from the application of provisions of that Directive on large exposures; and to adjust the criteria for the assessment by supervisors under that Directive of the suitability of a proposed acquirer for a credit institution and the financial soundness of any proposed acquisition.

[1] OJ C 321, 31.12.2003, p. 1.

(42) The Commission should also be empowered to adopt delegated acts in accordance with Article 290 TFEU in respect of technical adjustments to Directive 2006/49/EC to clarify definitions to ensure uniform application of that Directive or to take account of developments on financial markets; to adjust the amounts of initial capital prescribed by certain provisions of that Directive and specific amounts relevant to the calculation of capital requirements for the trading book to take account of developments in the economic and monetary field; to adjust the categories of investment firms eligible for certain derogations to required minimum levels of own funds to take account of developments on financial markets; to clarify the requirement that investment firms hold own funds equivalent to one quarter of their fixed overheads of the preceding year to ensure uniform application of that Directive; to align terminology and definitions with subsequent relevant acts; to adjust technical provisions of that Directive on the calculation of capital requirements for various classes of risk and large exposures, on the use of internal models to calculate capital requirements and on trading in order to take account of developments on financial markets or in risk measurement or accounting standards, or in Union legislation, or which have regard to the convergence of supervisory practices; and to take account of the outcome of the review of various matters relating to the scope of Directive 2004/39/EC.

(43) The European Parliament and the Council should have 3 months from the date of notification to object to a delegated act. At the initiative of the European Parliament or the Council, it should also be possible to prolong that period by 3 months. It should be possible for the European Parliament and the Council to inform the other institutions of their intention not to raise objections. Such early approval of delegated acts is particularly appropriate when deadlines need to be met, for example where there are timetables in the basic act for the Commission to adopt delegated acts.

(44) In Declaration 39 on Article 290 of the Treaty on the Functioning of the European Union, annexed to the Final Act of the Intergovernmental Conference which adopted the Treaty of Lisbon, signed on 13 December 2007, the Conference took note of the Commission's intention to continue to consult experts appointed by the Member States in the preparation of draft delegated acts in the financial services area, in accordance with its established practice.

(45) Since the objectives of this Directive, namely to require credit institutions and investment firms to establish remuneration policies that are consistent with effective risk management and to adjust certain capital requirements, cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale and effects of the action, be better achieved at Union level, the Union may adopt measures, in accordance with the principle of subsidiarity as set out in Article 5 of the Treaty on European Union. In accordance with the principle of proportionality, as set out in that Article, this Directive does not go beyond what is necessary in order to achieve those objectives.

(46) Directives 2006/48/EC and 2006/49/EC should therefore be amended accordingly,

HAVE ADOPTED THIS DIRECTIVE:

Article 1

Amendments to Directive 2006/48/EC

Directive 2006/48/EC is hereby amended as follows:

1. Article 4 is amended as follows:

   (a) the following points are inserted:

   '(40a) "re-securitisation" means a securitisation where the risk associated with an underlying pool of exposures is tranched and at least one of the underlying exposures is a securitisation position;

   (40b) "re-securitisation position" means an exposure to a re-securitisation;';

   (b) the following point is added:

   '(49) "discretionary pension benefits" means enhanced pension benefits granted on a discretionary basis by a credit institution to an employee as part of that employee's variable remuneration package, which do not include accrued benefits granted to an employee under the terms of the company pension scheme.'.

2. In Article 11(1), the following subparagraph is added:

'The Committee of European Banking Supervisors shall ensure the existence of guidelines for the assessment of the suitability of the persons who effectively direct the business of the credit institution.'.

3. Article 22 is amended as follows:

   (a) paragraph 1 is replaced by the following:

   '1. Home Member State competent authorities shall require that every credit institution have robust governance arrangements, which include a clear organisational structure with well-defined, transparent and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks it is or might be exposed to, adequate internal control mechanisms, including sound administration and accounting procedures, and remuneration policies and practices that are consistent with and promote sound and effective risk management.';

(b) the following paragraphs are added:

'3. Home Member State competent authorities shall use the information collected in accordance with the criteria for disclosure established in point 15(f) of part 2 of Annex XII to benchmark remuneration trends and practices. The competent authorities shall provide the Committee of European Banking Supervisors with that information.

4. The Committee of European Banking Supervisors shall ensure the existence of guidelines on sound remuneration policies which comply with the principles set out in points 23 and 24 of Annex V. The guidelines shall take into account the principles on sound remuneration policies set out in the Commission Recommendation of 30 April 2009 on remuneration policies in the financial services sector (*).

The Committee of European Banking Supervisors shall, inter alia, ensure the existence of guidelines to:

(a) set specific criteria to determine the appropriate ratios between the fixed and the variable component of the total remuneration within the meaning of point 23(l) of Annex V;

(b) specify instruments that can be eligible as instruments within the meaning of point 23(o)(ii) of Annex V that adequately reflect the credit quality of credit institutions within the meaning of point 23(o) of that Annex.

The Committee of European Securities Regulators shall cooperate closely with the Committee of European Banking Supervisors in ensuring the existence of guidelines on remuneration policies for categories of staff involved in the provision of investment services and activities within the meaning of point 2 of Article 4(1) of Directive 2004/39/EC.

The Committee of European Banking Supervisors shall use the information received from the competent authorities in accordance with paragraph 3 to benchmark remuneration trends and practices at the Union level.

5. Home Member State competent authorities shall collect information on the number of individuals per credit institution in pay brackets of at least EUR 1 million including the business area involved and the main elements of salary, bonus, long-term award and pension contribution. That information shall be forwarded to the Committee of European Banking Supervisors, which shall disclose it on an aggregate home Member State basis in a common reporting format. The Committee of European Banking Supervisors may elaborate guidelines to facilitate the implementation of this paragraph and ensure the consistency of the information collected.

(*) OJ L 120, 15.5.2009, p. 22.'.

4. In Article 54, the following paragraph is added:

'Member States shall ensure that, for the purposes of the first paragraph, their respective competent authorities have the power to impose or apply financial and non-financial penalties or other measures. Those penalties or measures shall be effective, proportionate and dissuasive.'.

5. In the first paragraph of Article 57, point (r) is replaced by the following:

'(r) the exposure amount of securitisation positions which receive a risk weight of 1 250 % under this Directive and the exposure amount of securitisation positions in the trading book that would receive a 1 250 % risk weight if they were in the same credit institutions non-trading book.'.

6. In Article 64, the following paragraph is added:

'5. Credit institutions shall apply the requirements of Part B of Annex VII to Directive 2006/49/EC to all their assets measured at fair value when calculating the amount of own funds and shall deduct from the total of the items (a) to (ca) minus (i) to (k) in Article 57 the amount of any additional value adjustments necessary. The Committee of European Banking Supervisors shall establish guidelines regarding the details of the application of this provision.'.

7. In Article 66, paragraph 2 is replaced by the following:

'2. Half of the total of the items in Article 57(l) to (r) shall be deducted from the total of the items in points (a) to (ca) minus (i) to (k) of that Article, and half from the total of the items in points (d) to (h) of that Article, after application of the limits laid down in paragraph 1 of this Article. To the extent that half of the total of the items in points (l) to (r) exceeds the total of the items in Article 57(d) to (h), the excess shall be deducted from the total of the items in points (a) to (ca) minus (i) to (k) of that Article.

Items in Article 57(r) shall not be deducted if they have been included for the purposes of Article 75 in the calculation of risk-weighted exposure amounts as specified in this Directive or in the calculation of capital requirements as specified in Annex I or V to Directive 2006/49/EC.'.

8. In Article 75, points (b) and (c) are replaced by the following:

'(b) in respect of their trading-book business, for position risk and counter-party risk and, in so far as it is authorised that the limits laid down in Articles 111 to 117 are exceeded, for large exposures exceeding such limits, the capital requirements determined in accordance with Article 18 and Articles 28 to 32 of Directive 2006/49/EC;

(c) in respect of all their business activities, for foreign exchange risk, for settlement risk and for commodities risk, the capital requirements determined in accordance with Article 18 of Directive 2006/49/EC;'.

9. In Article 101, paragraph 1 is replaced by the following:

'1. A sponsor credit institution, or an originator credit institution which in respect of a securitisation has made use of Article 95 in the calculation of risk-weighted exposure amounts or has sold instruments from its trading book to a securitisation special purpose entity to the effect that it is no longer required to hold own funds for the risks of those instruments shall not, with a view to reducing potential or actual losses to investors, provide support to the securitisation beyond its contractual obligations.'.

10. Article 136 is amended as follows:

(a) in the second subparagraph of paragraph 1, the following points are added:

'(f) requiring credit institutions to limit variable remuneration as a percentage of total net revenues when it is inconsistent with the maintenance of a sound capital base;

(g) requiring credit institutions to use net profits to strengthen the capital base.';

(b) in paragraph 2, the following subparagraph is added:

'For the purposes of determining the appropriate level of own funds on the basis of the review and evaluation carried out in accordance with Article 124, the competent authorities shall assess whether any imposition of a specific own funds requirement in excess of the minimum level is required to capture risks to which a credit institution is or might be exposed, taking into account the following:

(a) the quantitative and qualitative aspects of the credit institutions' assessment process referred to in Article 123;

(b) the credit institutions' arrangements, processes and mechanisms referred to in Article 22;

(c) the outcome of the review and evaluation carried out in accordance with Article 124.'.

11. In Article 145, paragraph 3 is replaced by the following:

'3. Credit institutions shall adopt a formal policy to comply with the disclosure requirements laid down in paragraphs 1 and 2, and have policies for assessing the appropriateness of their disclosures, including their verification and frequency. Credit institutions shall also have policies for assessing whether their disclosures convey their risk profile comprehensively to market participants.

Where those disclosures do not convey the risk profile comprehensively to market participants, credit institutions shall publicly disclose the information necessary in addition to that required in accordance with paragraph 1. However, they shall only be required to disclose information which is material and not proprietary or confidential in accordance with the technical criteria set out in Part 1 of Annex XII.'.

12. The title of Title VI is replaced by the following:

'**DELEGATED ACTS AND POWERS OF EXECUTION**'.

13. Article 150 is amended as follows:

(a) paragraph 1 is replaced by the following:

'1. Without prejudice, as regards own funds, to the proposal that the Commission is to submit pursuant to Article 62, the technical adjustments in the following areas shall be adopted by means of delegated acts in accordance with Article 151a, and subject to the conditions of Articles 151b and 151c:

(a) clarification of the definitions to ensure uniform application of this Directive;

(b) clarification of the definitions in order to take account, in the application of this Directive, of developments on financial markets;

(c) the alignment of terminology on, and the framing of definitions in accordance with, subsequent acts on credit institutions and related matters;

(d) expansion of the content of the list referred to in Articles 23 and 24 and set out in Annex I or adaptation of the terminology used in that list to take account of developments on financial markets;

(e) the areas in which the competent authorities shall exchange information as listed in Article 42;

(f) technical adjustments in Articles 56 to 67 and in Article 74 as a result of developments in accounting standards or requirements which take account of Union legislation or with regard to the convergence of supervisory practices;

(g) amendment of the list of exposure classes in Articles 79 and 86 in order to take account of developments on financial markets;

(h) the amount specified in Article 79(2)(c), Article 86(4)(a), Annex VII, Part 1, point 5 and Annex VII, Part 2, point 15, to take into account the effects of inflation;

(i) the list and classification of off-balance sheet items in Annexes II and IV;

(j) adjustment of the provisions in Annexes III and V to XII in order to take account of developments on financial markets (in particular new financial products) or in accounting standards or requirements which take account of Union legislation, or with regard to the convergence of supervisory practices.

1a. The following measures shall be adopted in accordance with the regulatory procedure referred to in Article 151(2a):

(a) technical adjustments to the list in Article 2;

(b) alteration of the amount of initial capital prescribed in Article 9 to take account of developments in the economic and monetary field.';

(b) paragraph 2 is amended as follows:

(i) in the first subparagraph, the introductory part is replaced by the following:

'The Commission may adopt the following measures:';

(ii) the second subparagraph is replaced by the following:

'The measures referred to in points (a), (b), (c) and (f) of the first subparagraph shall be adopted by means of delegated acts in accordance with Article 151a, and subject to the conditions of Articles 151b and 151c. The measures referred to in points (d) and (e) of the first subparagraph shall be adopted in accordance with the regulatory procedure referred to in Article 151(2a).'.

14. In Article 151, paragraphs 2 and 3 are deleted.

15. The following articles are inserted:

'*Article 151a*

Exercise of the delegation

1. The power to adopt delegated acts referred to in Article 150(1) and the first sentence of the second subparagraph of Article 150(2) shall be conferred on the Commission for a period of 4 years from 15 December 2010. The Commission shall draw up a report in respect of the delegated power at the latest 6 months before the end of the four-year period. The delegation of power shall be automatically extended for periods of an identical duration, unless the European Parliament or the Council revokes it in accordance with Article 151b.

2. As soon as it adopts a delegated act, the Commission shall notify it simultaneously to the European Parliament and to the Council.

3. The power to adopt delegated acts is conferred on the Commission subject to the conditions laid down in Articles 151b and 151c.

Article 151b

Revocation of the delegation

1. The delegation of power referred to in Article 150(1) and the first sentence of the second subparagraph of Article 150(2) may be revoked at any time by the European Parliament or by the Council.

2. The institution which has commenced an internal procedure for deciding whether to revoke a delegation of power shall endeavour to inform the other institution and the Commission within a reasonable time before the final decision is taken, indicating the delegated power which could be subject to revocation.

3. The decision of revocation shall put an end to the delegation of the power specified in that decision. It shall take effect immediately or at a later date specified therein. It shall not affect the validity of the delegated acts already in force. It shall be published in the *Official Journal of the European Union*.

Article 151c

Objections to delegated acts

1. The European Parliament or the Council may object to a delegated act within a period of 3 months from the date of notification. At the initiative of the European Parliament or the Council that period shall be extended by 3 months.

2. If, on the expiry of the period referred to in paragraph 1, neither the European Parliament nor the Council has objected to the delegated act, it shall be published in the *Official Journal of the European Union* and shall enter into force on the date stated therein. The delegated act may be published in the *Official Journal of the European Union* and enter into force before the expiry of that period if the European Parliament and the Council have both informed the Commission of their intention not to raise objections.

3. If either the European Parliament or the Council objects to the delegated act within the period referred to in paragraph 1, it shall not enter into force. In accordance with Article 296 TFEU, the institution which objects shall state the reasons for objecting to the delegated act.'.

16. In Article 152, the following paragraphs are inserted:

'5a. Credit institutions calculating risk-weighted exposure amounts in accordance with Articles 84 to 89 shall until 31 December 2011 provide own funds which are at all times more than or equal to the amount indicated in paragraph 5c or paragraph 5d if applicable.

5b. Credit institutions using the Advanced Measurement Approaches as specified in Article 105 for the calculation of their capital requirements for operational risk shall until 31 December 2011 provide own funds which are at all times more than or equal to the amount indicated in paragraph 5c or 5d if applicable.

5c. The amount referred to in paragraphs 5a and 5b shall be 80 % of the total minimum amount of own funds that the credit institutions would be required to hold under Article 4 of Directive 93/6/EEC and Directive 2000/12/EC, as applicable prior to 1 January 2007.

5d. Subject to the approval of the competent authorities, for credit institutions referred to in paragraph 5e, the amount referred to in paragraphs 5a and 5b may amount to up to 80 % of the total minimum amount of own funds that those credit institutions would be required to hold under any of Articles 78 to 83, 103 or 104 and Directive 2006/49/EC, as applicable prior to 1 January 2011.

5e. A credit institution may apply paragraph 5d only if it started to use the IRB Approach or the Advanced Measurement Approaches for the calculation of its capital requirements on or after 1 January 2010.'.

17. Article 154(5) is replaced by the following:

'5. Until 31 December 2012, the exposure weighted average LGD for all retail exposures secured by residential properties and not benefiting from guarantees from central governments shall not be lower than 10 %.'.

18. In Article 156, the following paragraphs are inserted after the third paragraph:

'By 1 April 2013 the Commission shall review and report on the provisions on remuneration, including those set out in Annexes V and XII, with particular regard to their efficiency, implementation and enforcement, taking into account international developments. That review shall identify any lacunae arising from the application of the principle of proportionality to those provisions. The Commission shall submit its report to the European Parliament and the Council together with any appropriate proposals.

In order to ensure consistency and a level playing field, the Commission shall review the implementation of Article 54 with regard to the consistency of the penalties and other measures imposed and applied across the Union and, if appropriate, shall put forward proposals.

The Commission's periodic review of the application of this Directive shall ensure that the way it is applied does not result in manifest discrimination between credit institutions on the basis of their legal structure or ownership model.

In order to ensure consistency in the prudential approach to capital, the Commission shall review the relevance of the reference to instruments within the meaning of Article 66(1a)(a) in point 23(o)(ii) of Annex V as soon as it takes an initiative to review the definition of capital instruments as provided for in Articles 56 to 67.'.

19. The following article is inserted:

'Article 156a

By 31 December 2011 the Commission shall review and report on the desirability of changes to align Annex IX of this Directive taking into consideration international agreements regarding the capital requirements of credit institutions for securitisation positions. The Commission shall submit that report to the European Parliament and the Council together with any appropriate legislative proposals.'.

20. The Annexes are amended as set out in Annex I to this Directive.

Article 2

Amendments to Directive 2006/49/EC

Directive 2006/49/EC is hereby amended as follows:

1. In the first subparagraph of Article 3(1), the following point is added:

'(t) "securitisation position" and "re-securitisation position" mean, respectively, securitisation position and re-securitisation position as defined in Directive 2006/48/EC.'.

2. In the first subparagraph of Article 17(1), the introductory part is replaced by the following:

'Where an institution calculates risk-weighted exposure amounts for the purposes of Annex II to this Directive in accordance with Articles 84 to 89 of Directive 2006/48/EC, the following shall apply for the purposes of the calculation provided for in point 36 of Part 1 of Annex VII to Directive 2006/48/EC:'.

3. In Article 18(1), point (a) is replaced by the following:

'(a) the capital requirements, calculated in accordance with the methods and options laid down in Articles 28 to 32 and Annexes I, II, and VI and, as appropriate, Annex V, for their trading book business, and points 1 to 4 of Annex II for their non-trading book business;'.

4. The title of Section 2 of Chapter VIII is replaced by the following:

'Delegated acts and powers of execution'.

5. Article 41(2) is replaced by the following:

'2. The measures referred to in paragraph 1 shall be adopted by means of delegated acts in accordance with Article 42a, and subject to the conditions of Articles 42b and 42c.'.

6. In Article 42, paragraph 2 is deleted.

7. The following articles are inserted:

'*Article 42a*

Exercise of the delegation

1. The power to adopt delegated acts referred to in Article 41 shall be conferred on the Commission for a period of 4 years from 15 December 2010. The Commission shall draw up a report in respect of the delegated power at the latest 6 months before the end of the four-year period. The delegation of power shall be automatically extended for periods of an identical duration, unless the European Parliament or the Council revokes it in accordance with Article 42b.

2. As soon as it adopts a delegated act, the Commission shall notify it simultaneously to the European Parliament and to the Council.

3. The power to adopt delegated acts is conferred on the Commission subject to the conditions laid down in Articles 42b and 42c.

Article 42b

Revocation of the delegation

1. The delegation of power referred to in Article 41 may be revoked at any time by the European Parliament or by the Council.

2. The institution which has commenced an internal procedure for deciding whether to revoke a delegation of power shall endeavour to inform the other institution and the Commission within a reasonable time before the final decision is taken, indicating the delegated power which could be subject to revocation.

3. The decision of revocation shall put an end to the delegation of the power specified in that decision. It shall take effect immediately or at a later date specified therein. It shall not affect the validity of the delegated acts already in force. It shall be published in the *Official Journal of the European Union*.

Article 42c

Objections to delegated acts

1. The European Parliament or the Council may object to a delegated act within a period of 3 months from the date of notification. At the initiative of the European Parliament or the Council that period shall be extended by 3 months.

2. If, on the expiry of the period referred to in paragraph 1, neither the European Parliament nor the Council has objected to the delegated act, it shall be published in the *Official Journal of the European Union* and shall enter into force on the date stated therein. The delegated act may be published in the *Official Journal of the European Union* and enter into force before the expiry of that period if the European Parliament and the Council have both informed the Commission of their intention not to raise objections.

3. If either the European Parliament or the Council objects to the delegated act within the period referred to in paragraph 1, it shall not enter into force. In accordance with Article 296 of the Treaty on the Functioning of the European Union, the institution which objects shall state the reasons for objecting to the delegated act.'.

8. Article 47 is replaced by the following:

'Until 30 December 2011 or any earlier date specified by the competent authorities on a case-by-case basis, institutions that have received specific risk-model recognition prior to 1 January 2007 in accordance with point 1 of Annex V may, for that existing recognition, apply points 4 and 8 of Annex VIII to Directive 93/6/EEC as those points stood prior to 1 January 2007.'.

9. The Annexes are amended as set out in Annex II to this Directive.

Article 3

Transposition

1. Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with:

(a) points 3, 4, 16 and 17 of Article 1 and points 1, 2(c), 3 and 5(b)(iii) of Annex I, by 1 January 2011; and

(b) the provisions of this Directive other than those specified in point (a), by 31 December 2011.

When Member States adopt the measures referred to in this paragraph, they shall contain a reference to this Directive or shall be accompanied by such reference on the occasion of their official publication. The methods of making such reference shall be laid down by Member States.

2. The laws, regulations and administrative provisions necessary to comply with point 1 of Annex I shall require credit institutions to apply the principles laid down therein to:

(i) remuneration due on basis of contracts concluded before the effective date of implementation in each Member State and awarded or paid after that date; and

(ii) for services provided in 2010, remuneration awarded, but not yet paid, before the date of effective implementation in each Member State.

3. Member States shall communicate to the Commission the text of the main provisions of national law which they adopt in the field covered by this Directive.

Article 4

Report

With regard to the international nature of the Basel framework and the risks associated with a non- simultaneous implementation of the changes to that framework in major jurisdictions, the Commission shall report to the European Parliament and the Council by 31 December 2010 on progress made towards the international implementation of the changes to the capital adequacy framework, together with any appropriate proposals.

Article 5

Entry into force

This Directive shall enter into force on the day following its publication in the *Official Journal of the European Union*.

Article 6

Addressees

This Directive is addressed to the Member States.

Done at Strasbourg, 24 November 2010.

For the European Parliament	*For the Council*
The President	*The President*
J. BUZEK	O. CHASTEL

ANNEX I

Annexes V, VI, VII, IX and XII to Directive 2006/48/EC are amended as follows:

(1) In Annex V, the following Section is added:

'11. REMUNERATION POLICIES

23. When establishing and applying the total remuneration policies, inclusive of salaries and discretionary pension benefits, for categories of staff including senior management, risk takers, staff engaged in control functions and any employee receiving total remuneration that takes them into the same remuneration bracket as senior management and risk takers, whose professional activities have a material impact on their risk profile, credit institutions shall comply with the following principles in a way and to the extent that is appropriate to their size, internal organisation and the nature, the scope and the complexity of their activities:

(a) the remuneration policy is consistent with and promotes sound and effective risk management and does not encourage risk-taking that exceeds the level of tolerated risk of the credit institution;

(b) the remuneration policy is in line with the business strategy, objectives, values and long-term interests of the credit institution, and incorporates measures to avoid conflicts of interest;

(c) the management body, in its supervisory function, of the credit institution adopts and periodically reviews the general principles of the remuneration policy and is responsible for its implementation;

(d) the implementation of the remuneration policy is, at least annually, subject to central and independent internal review for compliance with policies and procedures for remuneration adopted by the management body in its supervisory function;

(e) staff engaged in control functions are independent from the business units they oversee, have appropriate authority, and are remunerated in accordance with the achievement of the objectives linked to their functions, independent of the performance of the business areas they control;

(f) the remuneration of the senior officers in the risk management and compliance functions is directly overseen by the remuneration committee referred to in point (24) or, if such a committee has not been established, by the management body in its supervisory function;

(g) where remuneration is performance related, the total amount of remuneration is based on a combination of the assessment of the performance of the individual and of the business unit concerned and of the overall results of the credit institution and when assessing individual performance, financial and non-financial criteria are taken into account;

(h) the assessment of the performance is set in a multi-year framework in order to ensure that the assessment process is based on longer-term performance and that the actual payment of performance-based components of remuneration is spread over a period which takes account of the underlying business cycle of the credit institution and its business risks;

(i) the total variable remuneration does not limit the ability of the credit institution to strengthen its capital base;

(j) guaranteed variable remuneration is exceptional and occurs only when hiring new staff and is limited to the first year of employment;

(k) in the case of credit institutions that benefit from exceptional government intervention:

(i) variable remuneration is strictly limited as a percentage of net revenue where it is inconsistent with the maintenance of a sound capital base and timely exit from government support;

(ii) the relevant competent authorities require credit institutions to restructure remuneration in a manner aligned with sound risk management and long-term growth, including, where appropriate, establishing limits to the remuneration of the persons who effectively direct the business of the credit institution within the meaning of Article 11(1);

(iii) no variable remuneration is paid to the persons who effectively direct the business of the credit institution within the meaning of Article 11(1) unless justified;

(l) fixed and variable components of total remuneration are appropriately balanced and the fixed component represents a sufficiently high proportion of the total remuneration to allow the operation of a fully flexible policy, on variable remuneration components, including the possibility to pay no variable remuneration component.

Credit institutions shall set the appropriate ratios between the fixed and the variable component of the total remuneration;

(m) payments related to the early termination of a contract reflect performance achieved over time and are designed in a way that does not reward failure;

(n) the measurement of performance used to calculate variable remuneration components or pools of variable remuneration components includes an adjustment for all types of current and future risks and takes into account the cost of the capital and the liquidity required.

The allocation of the variable remuneration components within the credit institution shall also take into account all types of current and future risks;

(o) a substantial portion, and in any event at least 50 %, of any variable remuneration shall consist of an appropriate balance of:

(i) shares or equivalent ownership interests, subject to the legal structure of the credit institution concerned or share-linked instruments or equivalent non-cash instruments, in case of a non-listed credit institution, and

(ii) where appropriate, other instruments within the meaning of Article 66(1a)(a), that adequately reflect the credit quality of the credit institution as a going concern.

The instruments referred to in this point shall be subject to an appropriate retention policy designed to align incentives with the longer-term interests of the credit institution. Member States or their competent authorities may place restrictions on the types and designs of those instruments or prohibit certain instruments as appropriate. This point shall be applied to both the portion of the variable remuneration component deferred in accordance with point (p) and the portion of the variable remuneration component not deferred;

(p) a substantial portion, and in any event at least 40 %, of the variable remuneration component is deferred over a period which is not less than three to 5 years and is correctly aligned with the nature of the business, its risks and the activities of the member of staff in question.

Remuneration payable under deferral arrangements shall vest no faster than on a pro-rata basis. In the case of a variable remuneration component of a particularly high amount, at least 60 % of the amount shall be deferred. The length of the deferral period shall be established in accordance with the business cycle, the nature of the business, its risks and the activities of the member of staff in question;

(q) the variable remuneration, including the deferred portion, is paid or vests only if it is sustainable according to the financial situation of the credit institution as a whole, and justified according to the performance of the credit institution, the business unit and the individual concerned.

Without prejudice to the general principles of national contract and labour law, the total variable remuneration shall generally be considerably contracted where subdued or negative financial performance of the credit institution occurs, taking into account both current remuneration and reductions in payouts of amounts previously earned, including through *malus* or clawback arrangements;

(r) the pension policy is in line with the business strategy, objectives, values and long-term interests of the credit institution.

If the employee leaves the credit institution before retirement, discretionary pension benefits shall be held by the credit institution for a period of 5 years in the form of instruments referred to in point (o). In case of an employee reaching retirement, discretionary pension benefits shall be paid to the employee in the form of instruments referred to in point (o) subject to a five-year retention period;

(s) staff members are required to undertake not to use personal hedging strategies or remuneration- and liability-related insurance to undermine the risk alignment effects embedded in their remuneration arrangements;

(t) variable remuneration is not paid through vehicles or methods that facilitate the avoidance of the requirements of this Directive.

The principles set out in this point shall be applied by credit institutions at group, parent company and subsidiary levels, including those established in offshore financial centres.

24. Credit institutions that are significant in terms of their size, internal organisation and the nature, the scope and the complexity of their activities shall establish a remuneration committee. The remuneration committee shall be constituted in such a way as to enable it to exercise competent and independent judgment on remuneration policies and practices and the incentives created for managing risk, capital and liquidity.

The remuneration committee shall be responsible for the preparation of decisions regarding remuneration, including those which have implications for the risk and risk management of the credit institution concerned and which are to be taken by the management body in its supervisory function. The Chair and the members of the remuneration committee shall be members of the management body who do not perform any executive functions in the credit institution concerned. When preparing such decisions, the remuneration committee shall take into account the long-term interests of shareholders, investors and other stakeholders in the credit institution.'.

(2) Part 1 of Annex VI is amended as follows:

(a) point 8 is replaced by the following:

'8. Without prejudice to points 9, 10 and 11, exposures to regional governments and local authorities shall be risk-weighted as exposures to institutions, subject to point 11a. Such treatment is independent of the exercise of discretion specified in Article 80(3). The preferential treatment for short-term exposures specified in points 31, 32 and 37 shall not be applied.';

(b) the following point is inserted:

'11a. Without prejudice to points 9, 10 and 11, exposures to regional governments and local authorities of the Member States denominated and funded in the domestic currency of that regional government and local authority shall be assigned a risk weight of 20 %.'

(c) point 68 is amended as follows:

(i) in the first paragraph, points (d) and (e) are replaced by the following:

'(d) loans secured by residential real estate or shares in Finnish residential housing companies as referred to in point 46 up to the lesser of the principal amount of the liens that are combined with any prior liens and 80 % of the value of the pledged properties or by senior units issued by French *Fonds Communs de Créances* or by equivalent securitisation entities governed by the laws of a Member State securitising residential real estate exposures. In the event of such senior units being used as collateral, the special public supervision to protect bond holders as provided for in Article 52(4) of Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (*) shall ensure that the assets underlying such units shall, at any time while they are included in the cover pool be at least 90 % composed of residential mortgages that are combined with any prior liens up to the lesser of the principal amounts due under the units, the principal amounts of the liens, and 80 % of the value of the pledged properties, that the units qualify for the credit quality step 1 as set out in this Annex and that such units do not exceed 10 % of the nominal amount of the outstanding issue.

Exposures caused by transmission and management of payments of the obligors of, or liquidation proceeds in respect of, loans secured by pledged properties of the senior units or debt securities shall not be comprised in calculating the 90 % limit;

(e) loans secured by commercial real estate or shares in Finnish housing companies as referred to in point 52 up to the lesser of the principal amount of the liens that are combined with any prior liens and 60 % of the value of the pledged properties or by senior units issued by French *Fonds Communs de Créances* or by equivalent securitisation entities governed by the laws of a Member State securitising commercial real estate exposures. In the event of such senior units being used as collateral, the special public supervision to protect bond holders as provided for in Article 52(4) of Directive 2009/65/EC shall ensure that the assets underlying such units shall, at any time while they are included in the cover pool be at least 90 % composed of commercial mortgages that are combined with any prior liens up to the lesser of the principal amounts due under the units, the principal amounts of the liens, and 60 % of the value of the pledged properties, that the units qualify for the credit quality step 1 as set out in this Annex and that such units do not exceed 10 % of the nominal amount of the outstanding issue.

The competent authorities may recognise loans secured by commercial real estate as eligible where the Loan-to-value ratio of 60 % is exceeded up to a maximum level of 70 % if the value of the total assets pledged as collateral for the covered bonds exceed the nominal amount outstanding on the covered bond by at least 10 %, and the bondholders' claim meets the legal certainty requirements set out in Annex VIII. The bondholders' claim shall take priority over all other claims on the collateral. Exposures caused by transmission and management of payments of the obligors of, or liquidation proceeds in respect of, loans secured by pledged properties of the senior units or debt securities shall not be comprised in calculating the 90 % limit;

(*) OJ L 302, 17.11.2009, p. 32.';

(ii) the third paragraph is replaced by the following:

'Until 31 December 2013, the 10 % limit for senior units issued by French *Fonds Communs de Créances* or by equivalent securitisation entities as specified in points (d) and (e) shall not apply, provided that:

(i) the securitised residential or commercial real estate exposures were originated by a member of the same consolidated group of which the issuer of the covered bonds is also a member or by an entity affiliated to the same central body to which the issuer of the covered bonds is also affiliated (that common group membership or affiliation to be determined at the time the senior units are made collateral for covered bonds; and

(ii) a member of the same consolidated group of which the issuer of the covered bonds is also a member or an entity affiliated to the same central body to which the issuer of the covered bonds is also affiliated retains the whole first loss tranche supporting those senior units.

By 31 December 2012, the Commission shall review the appropriateness of the derogation set out in the third paragraph and, if relevant, the appropriateness of extending similar treatment to any other form of covered bond. In the light of that review, the Commission may, if appropriate, adopt delegated acts in accordance with Article 151a, and subject to the conditions of Articles 151b and 151c, to prolong the derogation, make it permanent or extend it to other forms of covered bonds.'.

(3) In Annex VII, point 8(d) of section 1 of Part 2 is replaced by the following:

'(d) Covered bonds as defined in Annex VI, Part 1, points 68 to 70 may be assigned an LGD value of 11,25 %;'.

(4) Annex IX is amended as follows:

(a) in point 1 of Part 3, the following point is added:

'(c) The credit assessment shall not be based or partly based on unfunded support provided by the credit institution itself. In such case, the credit institution shall consider the relevant position as if it were not rated and shall apply the relevant treatment of unrated positions as set out in Part 4.';

(b) Part 4 is amended as follows:

(i) point 5 is replaced by the following:

'5. Where a credit institution has two or more overlapping positions in a securitisation, it will be required to the extent that they overlap to include in its calculation of risk-weighted exposure amounts only the position or portion of a position producing the higher risk-weighted exposure amounts. The credit institution may also recognise such overlap between specific risk capital charges for positions in the trading book and capital charges for positions in the banking book, provided that the credit institution is able to calculate and compare the capital charges for the relevant positions. For the purpose of this point "overlapping" occurs when the positions, wholly or partially, represent an exposure to the same risk such that the extent of the overlap there is a single exposure.

Where point 1(c) of Part 3 applies to positions in the ABCP, the credit institution may, subject to the approval of the competent authorities, use the risk-weight assigned to a liquidity facility in order to calculate the risk-weighted exposure amount for the ABCP if the liquidity facility ranks *pari passu* with the ABCP so that they form overlapping positions and 100 % of the ABCP issued by the programme is covered by liquidity facilities.';

(ii) point 6 is replaced by the following:

'6. Subject to point 8, the risk-weighted exposure amount of a rated securitisation or re-securitisation position shall be calculated by applying to the exposure value the risk weight associated with the credit quality step with which the credit assessment has been determined to be associated by the competent authorities in accordance with Article 98 as laid down in Table 1.';

(iii) Table 1 is replaced by the following:

'Table 1

Credit Quality Step	1	2	3	4 (only for credit assessments other than short-term credit assessments)	all other credit quality steps
Securitisation positions	20 %	50 %	100 %	350 %	1 250 %
Re-securitisation positions	40 %	100 %	225 %	650 %	1 250 %'

(iv) Table 2 is deleted;

(v) point 46 is replaced by the following:

'46. Under the Ratings Based Method, the risk-weighted exposure amount of a rated securitisation or re-securitisation position shall be calculated by applying to the exposure value the risk weight associated with the credit quality step with which the credit assessment has been determined to be associated by the competent authorities in accordance with Article 98, as set out in the Table 4, multiplied by 1,06.';

(vi) Table 4 is replaced by the following:

'Table 4

Credit Quality Step		Securitisation Positions			Re-securitisation Positions	
Credit assessments other than short term	Short term credit assessments	A	B	C	D	E
1	1	7 %	12 %	20 %	20 %	30 %
2		8 %	15 %	25 %	25 %	40 %
3		10 %	18 %	35 %	35 %	50 %
4	2	12 %	20 %		40 %	65 %
5		20 %	35 %		60 %	100 %
6		35 %	50 %		100 %	150 %
7	3	60 %	75 %		150 %	225 %
8		100 %			200 %	350 %
9		250 %			300 %	500 %
10		425 %			500 %	650 %
11		650 %			750 %	850 %
all other and unrated		1 250 %'				

(vii) Table 5 is deleted;

(viii) point 47 is replaced by the following:

'47. The weightings in column C of table 4 shall be applied where the securitisation position is not a re-securitisation position and where the effective number of exposures securitised is less than six. For the remainder of the securitisation positions that are not re-securitisation positions, the weightings in column B shall be applied unless the position is in the most senior tranche of a securitisation, in which case the weightings in column A shall be applied. For re-securitisation positions the weightings in column E shall be applied unless the re-securitisation position is in the most senior tranche of the re-securitisation and none of the underlying exposures were themselves re-securitisation exposures, in which case column D shall be applied. When determining whether a tranche is the most senior, it is not required to take into consideration amounts due under interest rate or currency derivative contracts, fees due, or other similar payments.';

(ix) point 48 is deleted;

(x) point 49 is replaced by the following:

'49. In calculating the effective number of exposures securitised multiple exposures to one obligor shall be treated as one exposure. The effective number of exposures is calculated as:

$$N = \frac{\left(\sum_i EAD_i\right)^2}{\sum_i EAD_i^2}$$

where EAD_i represents the sum of the exposure values of all exposures to the ith obligor. If the portfolio share associated with the largest exposure, C1, is available, the credit institution may compute N as 1/C1.';

(xi) point 50 is deleted;

(xii) point 52 is replaced by the following:

'52. Subject to points 58 and 59, under the Supervisory Formula Method, the risk weight for a securitisation position shall be the risk weight to be applied in accordance with point 53. However, the risk weight shall be no less than 20 % for re-securitisation positions and no less than 7 % for all other securitisation positions.';

(xiii) in point 53, the sixth paragraph is replaced by the following:

'N is the effective number of exposures calculated in accordance with point 49. In the case of re-securitisations, the credit institution shall look at the number of securitisation exposures in the pool and not the number of underlying exposures in the original pools from which the underlying securitisation exposures stem.'.

(5) Annex XII is amended as follows:

(a) the title is replaced by the following:

'TECHNICAL CRITERIA ON TRANSPARENCY AND DISCLOSURE';

(b) Part 2 is amended as follows:

(i) points 9 and 10 are replaced by the following:

'9. The credit institutions calculating their capital requirements in accordance with Article 75(b) and (c) shall disclose those requirements separately for each risk referred to in those provisions. In addition, the capital requirement for specific interest rate risk of securitisation positions shall be disclosed separately.

10. The following information shall be disclosed by each credit institution which calculates its capital requirements in accordance with Annex V to Directive 2006/49/EC:

(a) for each sub-portfolio covered:

(i) the characteristics of the models used;

(ii) for the capital charges in accordance with points 5a and 5l of Annex V to Directive 2006/49/EC separately, the methodologies used and the risks measured through the use of an internal model including a description of the approach used by the credit institution to determine liquidity horizons, the methodologies used to achieve a capital assessment that is consistent with the required soundness standard and the approaches used in the validation of the model;

(iii) a description of stress testing applied to the sub-portfolio;

(iv) a description of the approaches used for back-testing and validating the accuracy and consistency of the internal models and modelling processes;

(b) the scope of acceptance by the competent authority;

(c) a description of the extent and methodologies for compliance with the requirements set out in Part B of Annex VII to Directive 2006/49/EC;

(d) the highest, the lowest and the mean of the following:

(i) the daily value-at-risk measures over the reporting period and as per the period end;

(ii) the stressed value-at-risk measures over the reporting period and as per the period end;

(iii) the capital charges in accordance with points 5a and 5l of Annex V to Directive 2006/49/EC separately over the reporting period and as per the period-end;

(e) the amount of capital in accordance with points 5a and 5l of Annex V to Directive 2006/49/EC separately, together with the weighted average liquidity horizon for each sub-portfolio covered;

(f) a comparison of the daily end-of-day value-at-risk measures to the one-day changes of the portfolio's value by the end of the subsequent business day together with an analysis of any important over-shooting during the reporting period.';

(ii) point 14 is replaced by the following:

'14. Credit institutions calculating risk weighted exposure amounts in accordance with Articles 94 to 101 or capital requirements in accordance with point 16a of Annex I to Directive 2006/49/EC shall disclose the following information, where relevant, separately for their trading and non-trading book:

(a) a description of the credit institution's objectives in relation to securitisation activity;

(b) the nature of other risks including liquidity risk inherent in securitised assets;

(c) the type of risks in terms of seniority of underlying securitisation positions and in terms of assets underlying those latter securitisation positions assumed and retained with re-securitisation activity;

(d) the different roles played by the credit institution in the securitisation process;

(e) an indication of the extent of the credit institution's involvement in each of the roles referred to in point (d);

(f) a description of the processes in place to monitor changes in the credit and market risk of securitisation exposures including, how the behaviour of the underlying assets impacts securitisation exposures and a description of how those processes differ for re-securitisation exposures;

(g) a description of the credit institution's policy governing the use of hedging and unfunded protection to mitigate the risks of retained securitisation and re-securitisation exposures, including identification of material hedge counterparties by relevant type of risk exposure;

(h) the approaches to calculating risk weighted exposure amounts that the credit institution follows for its securitisation activities including the types of securitisation exposures to which each approach applies;

(i) the types of SSPE that the credit institution, as sponsor, uses to securitise third-party exposures including whether and in what form and to what extent the credit institution has exposures to those SSPEs, separately for on- and off-balance sheet exposures, as well as a list of the entities that the credit institution manages or advises and that invest in either the securitisation positions that the credit institution has securitised or in SSPEs that the credit institution sponsors;

(j) a summary of the credit institution's accounting policies for securitisation activities, including:

(i) whether the transactions are treated as sales or financings;

(ii) the recognition of gains on sales;

(iii) the methods, key assumptions, inputs and changes from the previous period for valuing securitisation positions;

(iv) the treatment of synthetic securitisations if not covered by other accounting policies;

(v) how assets awaiting securitisation are valued and whether they are recorded in the credit institution's non-trading book or the trading book;

(vi) policies for recognising liabilities on the balance sheet for arrangements that could require the credit institution to provide financial support for securitised assets;

(k) the names of the ECAIs used for securitisations and the types of exposure for which each agency is used;

(l) where applicable, a description of the Internal Assessment Approach as set out in Part 4 of Annex IX, including the structure of the internal assessment process and relation between internal assessment and external ratings, the use of internal assessment other than for IAA capital purposes, the control mechanisms for the internal assessment process including discussion of independence, accountability, and internal assessment process review, the exposure types to which the internal assessment process is applied and the stress factors used for determining credit enhancement levels, by exposure type;

(m) an explanation of significant changes to any of the quantitative disclosures in points (n) to (q) since the last reporting period;

(n) separately for the trading and the non-trading book, the following information broken down by exposure type:

(i) the total amount of outstanding exposures securitised by the credit institution, separately for traditional and synthetic securitisations and securitisations for which the credit institution acts only as sponsor;

(ii) the aggregate amount of on-balance sheet securitisation positions retained or purchased and off-balance sheet securitisation exposures;

(iii) the aggregate amount of assets awaiting securitisation;

(iv) for securitised facilities subject to the early amortisation treatment, the aggregate drawn exposures attributed to the originator's and investors' interests respectively, the aggregate capital requirements incurred by the credit institution against the originator's interest and the aggregate capital requirements incurred by the credit institution against the investor's shares of drawn balances and undrawn lines;

(v) the amount of securitisation positions that are deducted from own funds or risk-weighted at 1 250 %;

(vi) a summary of the securitisation activity of the current period, including the amount of exposures securitised and recognised gain or loss on sale;

(o) separately for the trading and the non-trading book, the following information:

(i) the aggregate amount of securitisation positions retained or purchased and the associated capital requirements, broken down between securitisation and re-securitisation exposures and further broken down into a meaningful number of risk-weight or capital requirement bands, for each capital requirements approach used;

(ii) the aggregate amount of re-securitisation exposures retained or purchased broken down according to the exposure before and after hedging/insurance and the exposure to financial guarantors, broken down according to guarantor credit worthiness categories or guarantor name;

(p) for the non-trading book and regarding exposures securitised by the credit institution, the amount of impaired/past due assets securitised and the losses recognised by the credit institution during the current period, both broken down by exposure type;

(q) for the trading book, the total outstanding exposures securitised by the credit institution and subject to a capital requirement for market risk, broken down into traditional/synthetic and by exposure type.';

(iii) the following point is added:

'15. The following information, including regular, at least annual, updates, shall be disclosed to the public regarding the remuneration policy and practices of the credit institution for those categories of staff whose professional activities have a material impact on its risk profile:

(a) information concerning the decision-making process used for determining the remuneration policy, including if applicable, information about the composition and the mandate of a remuneration committee, the external consultant whose services have been used for the determination of the remuneration policy and the role of the relevant stakeholders;

(b) information on link between pay and performance;

(c) the most important design characteristics of the remuneration system, including information on the criteria used for performance measurement and risk adjustment, deferral policy and vesting criteria;

(d) information on the performance criteria on which the entitlement to shares, options or variable components of remuneration is based;

(e) the main parameters and rationale for any variable component scheme and any other non-cash benefits;

(f) aggregate quantitative information on remuneration, broken down by business area;

(g) aggregate quantitative information on remuneration, broken down by senior management and members of staff whose actions have a material impact on the risk profile of the credit institution, indicating the following:

(i) the amounts of remuneration for the financial year, split into fixed and variable remuneration, and the number of beneficiaries;

(ii) the amounts and forms of variable remuneration, split into cash, shares, share-linked instruments and other types;

(iii) the amounts of outstanding deferred remuneration, split into vested and unvested portions;

(iv) the amounts of deferred remuneration awarded during the financial year, paid out and reduced through performance adjustments;

(v) new sign-on and severance payments made during the financial year, and the number of beneficiaries of such payments; and

(vi) the amounts of severance payments awarded during the financial year, number of beneficiaries and highest such award to a single person.

For credit institutions that are significant in terms of their size, internal organisation and the nature, scope and the complexity of their activities, the quantitative information referred to in this point shall also be made available to the public at the level of persons who effectively direct the business of the credit institution within the meaning of Article 11(1).

Credit institutions shall comply with the requirements set out in this point in a manner that is appropriate to their size, internal organisation and the nature, scope and complexity of their activities and without prejudice to Directive 95/46/EC.'.

ANNEX II

Annexes I, II, V and VII to Directive 2006/49/EC are amended as follows:

(1) Annex I is amended as follows:

(a) point 8 is amended as follows:

(i) in the first paragraph, the introductory part is replaced by the following:

'8. When calculating the capital requirement for market risk of the party who assumes the credit risk (the "protection seller"), unless specified differently, the notional amount of the credit derivative contract shall be used. Notwithstanding the first sentence, the institution may elect to replace the notional value by the notional value, minus any market value changes of the credit derivative since trade inception. For the purpose of calculating the specific risk charge, other than for total return swaps, the maturity of the credit derivative contract, rather than the maturity of the obligation, shall apply. Positions are determined as follows:';

(ii) in point (v), the third paragraph is replaced by the following:

'Where an n-th-to-default credit derivative is externally rated, the protection seller shall calculate the specific risk capital charge using the rating of the derivative and apply the respective securitisation risk weights as applicable.';

(b) in point 14, the first paragraph is replaced by the following:

'14. The institution shall assign its net positions in the trading book in instruments that are not securitisation positions as calculated in accordance with point 1 to the appropriate categories in Table 1 on the basis of their issuer/obligor, external or internal credit assessment, and residual maturity, and then multiply them by the weightings shown in that table. It shall sum its weighted positions resulting from the application of this point (regardless of whether they are long or short) in order to calculate its capital requirement against specific risk. It shall calculate its capital requirement against specific risk for positions that are securitisation positions in accordance with point 16a.

For the purposes of this point and points 14a and 16a, the institution may cap the product of the weight and the net position at the maximum possible default-risk related loss. For a short position, that limit may be calculated as a change in value due to the underlying names immediately becoming default risk-free.';

(c) the following points are inserted:

'14a. By way of derogation from point 14, an institution may determine the larger of the following amounts as the specific risk capital charge for the correlation trading portfolio:

(a) the total specific risk capital charges that would apply just to the net long positions of the correlation trading portfolio;

(b) the total specific risk capital charges that would apply just to the net short positions of the correlation trading portfolio.

14b. The correlation trading portfolio shall consist of securitisation positions and n-th-to-default credit derivatives that meet the following criteria:

(a) the positions are neither re-securitisation positions, nor options on a securitisation tranche, nor any other derivatives of securitisation exposures that do not provide a pro-rata share in the proceeds of a securitisation tranche; and

(b) all reference instruments are either single-name instruments, including single-name credit derivatives for which a liquid two-way market exists, or commonly-traded indices based on those reference entities. A two-way market is deemed to exist where there are independent bona fide offers to buy and sell so that a price reasonably related to the last sales price or current bona fide competitive bid and offer quotations can be determined within 1 day and settled at such price within a relatively short time conforming to trade custom.

14c. Positions which reference either of the following shall not be part of the correlation trading portfolio:

(a) an underlying that is capable of being assigned to the exposure classes referred to in Article 79(1)(h) and (i) of Directive 2006/48/EC in an institution's non-trading book; or

(b) a claim on a special purpose entity.

An institution may include in the correlation trading portfolio positions which are neither securitisation positions nor n-th-to-default credit derivatives but which hedge other positions of that portfolio, provided that a liquid two-way market as described in point 14b(b) exists for the instrument or its underlyings.';

(d) the following point is inserted:

'16a. For instruments in the trading book that are securitisation positions, the institution shall weight with the following its net positions as calculated in accordance with point 1:

(a) for securitisation positions that would be subject to the Standardised Approach for credit risk in the same institution's non-trading book, 8 % of the risk weight under the Standardised Approach as set out in Part 4 of Annex IX to Directive 2006/48/EC;

(b) for securitisation positions that would be subject to the Internal Ratings Based Approach in the same institution's non-trading book, 8 % of the risk weight under the Internal Ratings Based Approach as set out in Part 4 of Annex IX to Directive 2006/48/EC.

For the purpose of points (a) and (b), the Supervisory Formula Method may be used only with supervisory approval by institutions other than an originator institution that may apply it for the same securitisation position in its non-trading book. Where relevant, estimates of PD and LGD as inputs to the Supervisory Formula Method shall be determined in accordance with Articles 84 to 89 of Directive 2006/48/EC or alternatively and subject to separate supervisory approval, based on estimates that are derived from an approach set out in point 5a of Annex V and that are in line with the quantitative standards for the Internal Ratings Based Approach. The Committee of European Banking Supervisors shall establish guidelines in order to ensure a convergent use of estimates of PD and LGD as inputs when those estimates are based on the approach set out in point 5a of Annex V.

Notwithstanding points (a) and (b), for securitisation positions that would be subject to a risk weight in accordance with Article 122a of Directive 2006/48/EC if they were in the same institutions' non-trading book, 8 % of the risk weight in accordance with that Article shall be applied.

The institution shall sum its weighted positions resulting from the application of this point (regardless of whether they are long or short) in order to calculate its capital requirement against specific risk.

By way of derogation from the fourth paragraph, for a transitional period ending 31 December 2013, the institution shall sum separately its weighted net long positions and its weighted net short positions. The larger of those sums shall constitute the specific risk capital requirement. The institution shall, however, report to the home Member State competent authority the total sum of its weighted net long and net short positions, broken down by types of underlying assets.';

(e) point 34 is replaced by the following:

'34. The institution shall sum all its net long positions and all its net short positions in accordance with point 1. It shall multiply its overall gross position by 8 % in order to calculate its capital requirement against specific risk.';

(f) point 35 is deleted.

(2) In Annex II, the second paragraph of point 7 is replaced by the following:

'However, in the case of a credit default swap, an institution the exposure of which arising from the swap represents a long position in the underlying shall be permitted to use a figure of 0 % for potential future credit exposure, unless the credit default swap is subject to closeout upon insolvency of the entity the exposure of which arising from the swap represents a short position in the underlying, even though the underlying has not defaulted, in which case the figure for potential future credit exposure of the institution shall be limited to the amount of premia which are not yet paid by the entity to the institution.'.

(3) Annex V is amended as follows:

(a) point 1 is replaced by the following:

'1. The competent authorities shall, subject to the conditions laid down in this Annex, allow institutions to calculate their capital requirements for position risk, foreign-exchange risk and/or commodities risk using their own internal risk-management models instead of or in combination with the methods described in Annexes I, III and IV. Explicit recognition by the competent authorities of the use of models for supervisory capital purposes shall be required in each case.';

(b) in point 4, the second paragraph is replaced by the following:

'The competent authorities shall examine the institution's capability to perform back-testing on both actual and hypothetical changes in the portfolio's value. Back-testing on hypothetical changes in the portfolio's value is based on a comparison between the portfolio's end-of-day value and, assuming unchanged positions, its value at the end of the subsequent day. The competent authorities shall require institutions to take appropriate measures to improve their back-testing programme if deemed deficient. As a minimum, the competent authorities shall require institutions to perform back-testing on hypothetical (using changes in portfolio value that would occur were end-of-day positions to remain unchanged) outcomes.';

(c) point 5 is replaced by the following:

'5. For the purpose of calculating capital requirements for specific risk associated with traded debt and equity positions, the competent authorities shall recognise the use of an institution's internal model if, in addition to compliance with the conditions in the remainder of this Annex, the internal model meets the following conditions:

(a) it explains the historical price variation in the portfolio;

(b) it captures concentration in terms of magnitude and changes of composition of the portfolio;

(c) it is robust to an adverse environment;

(d) it is validated through back-testing aimed at assessing whether specific risk is being accurately captured. If the competent authorities allow such back-testing to be performed on the basis of relevant sub-portfolios, these must be chosen in a consistent manner;

(e) it captures name-related basis risk, namely institutions shall demonstrate that the internal model is sensitive to material idiosyncratic differences between similar but not identical positions;

(f) it captures event risk.

The institution's internal model shall conservatively assess the risk arising from less liquid positions and positions with limited price transparency under realistic market scenarios. In addition, the internal model shall meet minimum data standards. Proxies shall be appropriately conservative and may be used only where available data is insufficient or is not reflective of the true volatility of a position or portfolio.

An institution may choose to exclude from the calculation of its specific risk capital requirement using an internal model those positions in securitisations or n-th-to-default credit derivatives for which it meets a capital requirement for position risks in accordance with Annex I with the exception of those positions that are subject to the approach set out in point 5l.

As techniques and best practices evolve, institutions shall avail themselves of those new techniques and practices.

An institution shall not be required to capture default and migration risks for traded debt instruments in its internal model where it is capturing those risks through the requirements set out in points 5a to 5k.';

(d) The following points are inserted:

'5a. Institutions subject to point 5 for traded debt instruments shall have an approach in place to capture, in the calculation of their capital requirements, the default and migration risks of its trading book positions that are incremental to the risks captured by the value-at-risk measure as specified in point 5. An institution shall demonstrate that its approach meets soundness standards comparable to the approach set out in Articles 84 to 89 of Directive 2006/48/EC, under the assumption of a constant level of risk, and adjusted where appropriate to reflect the impact of liquidity, concentrations, hedging and optionality.

Scope

5b. The approach to capture the incremental default and migration risks shall cover all positions subject to a capital charge for specific interest rate risk but shall not cover securitisation positions and n-th-to-default credit derivatives. Subject to supervisory approval, the institution may choose to consistently include all listed equity positions and derivatives positions based on listed equities for which such inclusion is consistent with how the institution internally measures and manages risk. The approach shall reflect the impact of correlations between default and migration events. The impact of diversification between, on the one hand, default and migration events and, on the other hand, other market risk factors shall not be reflected.

Parameters

5c. The approach to capture the incremental risks shall measure losses due to default and internal or external ratings migration at the 99,9 % confidence interval over a capital horizon of 1 year.

Correlation assumptions shall be supported by analysis of objective data in a conceptually sound framework. The approach to capture the incremental risks shall appropriately reflect issuer concentrations. Concentrations that can arise within and across product classes under stressed conditions shall also be reflected.The approach shall be based on the assumption of a constant level of risk over the one-year capital horizon, implying that given individual trading book positions or sets of positions that have experienced default or migration over their liquidity horizon are re-balanced at the end of their liquidity horizon to attain the initial level of risk. Alternatively, an institution may choose to consistently use a one-year constant position assumption.

5d. The liquidity horizons shall be set according to the time required to sell the position or to hedge all material relevant price risks in a stressed market, having particular regard to the size of the position. Liquidity horizons shall reflect actual practice and experience during periods of both systematic and idiosyncratic stresses. The liquidity horizon shall be measured under conservative assumptions and shall be sufficiently long that the act of selling or hedging, in itself, would not materially affect the price at which the selling or hedging would be executed.

The determination of the appropriate liquidity horizon for a position or set of positions is subject to a floor of 3 months.

The determination of the appropriate liquidity horizon for a position or set of positions shall take into account an institution's internal policies relating to valuation adjustments and the management of stale positions. When an institution determines liquidity horizons for sets of positions rather than for individual positions, the criteria for defining sets of positions shall be defined in a way that meaningfully reflects differences in liquidity. The liquidity horizons shall be greater for positions that are concentrated, reflecting the longer period needed to liquidate such positions. The liquidity horizon for a securitisation warehouse shall reflect the time to build, sell and securitise the assets, or to hedge the material risk factors, under stressed market conditions.

5e. Hedges may be incorporated into an institution's approach to capture the incremental default and migration risks. Positions may be netted when long and short positions refer to the same financial instrument. Hedging or diversification effects associated with long and short positions involving different instruments or different securities of the same obligor, as well as long and short positions in different issuers, may only be recognised by explicitly modelling gross long and short positions in the different instruments. Institutions shall reflect the impact of material risks that could occur during the interval between the hedge's maturity and the liquidity horizon as well as the potential for significant basis risks in hedging strategies by product, seniority in the capital structure, internal or external rating, maturity, vintage and other differences in the instruments. An institution shall reflect a hedge only to the extent that it can be maintained even as the obligor approaches a credit or other event.

For trading book positions that are hedged via dynamic hedging strategies, a rebalancing of the hedge within the liquidity horizon of the hedged position may be recognised provided that the institution:

(i) chooses to model rebalancing of the hedge consistently over the relevant set of trading book positions,

(ii) demonstrates that the inclusion of rebalancing results in a better risk measurement, and

(iii) demonstrates that the markets for the instruments serving as hedges are liquid enough to allow for such rebalancing even during periods of stress. Any residual risks resulting from dynamic hedging strategies must be reflected in the capital charge.

5f. The approach to capture the incremental default and migration risks shall reflect the nonlinear impact of options, structured credit derivatives and other positions with material nonlinear behaviour with respect to price changes. The institution shall also have due regard to the amount of model risk inherent in the valuation and estimation of price risks associated with such products.

5g. The approach to capture the incremental default and migration risks shall be based on data that are objective and up-to-date.

Validation

5h. As part of the independent review of their risk measurement system and the validation of their internal models as required in this Annex, institutions shall, with a view to the approach to capture incremental default and migration risks, in particular:

(i) validate that its modelling approach for correlations and price changes is appropriate for its portfolio, including the choice and weights of its systematic risk factors;

(ii) perform a variety of stress tests, including sensitivity analysis and scenario analysis, to assess the qualitative and quantitative reasonableness of the approach, particularly with regard to the treatment of concentrations. Such tests shall not be limited to the range of events experienced historically;

(iii) apply appropriate quantitative validation including relevant internal modelling benchmarks.

The approach to capture the incremental risks shall be consistent with the institution's internal risk management methodologies for identifying, measuring, and managing trading risks.

Documentation

5i. An institution shall document its approach to capturing incremental default and migration risks so that its correlation and other modelling assumptions are transparent to the competent authorities.

Internal approaches based on different parameters

5j. If the institution uses an approach to capturing incremental default and migration risks that does not comply with all requirements of this point but that is consistent with the institution's internal methodologies for identifying, measuring and managing risks, it shall be able to demonstrate that its approach results in a capital requirement that is at least as high as if it was based on an approach in full compliance with the requirements of this point. The competent authorities shall review compliance with the previous sentence at least annually. The Committee of European Banking Supervisors shall monitor the range of practices in this area and draw up guidelines in order to secure a level playing field.

Frequency of calculation

5k. An institution shall perform the calculations required under its chosen approach to capture the incremental risk at least weekly.

5l. The competent authorities shall recognise the use of an internal approach for calculating an additional capital charge instead of a capital charge for the correlation trading portfolio in accordance with point 14a of Annex I provided that all conditions in this point are fulfilled.

Such an internal approach shall adequately capture all price risks at the 99,9 % confidence interval over a capital horizon of 1 year under the assumption of a constant level of risk, and adjusted where appropriate to reflect the impact of liquidity, concentrations, hedging and optionality. The institution may incorporate any positions in the approach referred to in this point that are jointly managed with positions of the correlation trading portfolio and may then exclude those positions from the approach required under point 5a.

The amount of the capital charge for all price risks shall not be less than 8 % of the capital charge that would be calculated in accordance with point 14a of Annex I for all positions incorporated in the charge for all price risks.

In particular, the following risks shall be adequately captured:

(a) the cumulative risk arising from multiple defaults, including the ordering of defaults, in tranched products;

(b) credit spread risk, including the gamma and cross-gamma effects;

(c) volatility of implied correlations, including the cross effect between spreads and correlations;

(d) basis risk, including both:

(i) the basis between the spread of an index and those of its constituent single names, and

(ii) the basis between the implied correlation of an index and that of bespoke portfolios;

(e) recovery rate volatility, as it relates to the propensity for recovery rates to affect tranche prices; and

(f) to the extent the comprehensive risk measure incorporates benefits from dynamic hedging, the risk of hedge slippage and the potential costs of rebalancing such hedges.

For the purpose of this point, an institution shall have sufficient market data to ensure that it fully captures the salient risks of those exposures in its internal approach in accordance with the standards set out in this point, demonstrates through back testing or other appropriate means that its risk measures can appropriately explain the historical price variation of those products, and is able to separate the positions for which it holds approval in order to incorporate them in the capital charge in accordance with this point from those positions for which it does not hold such approval.

With regard to portfolios subject to this point, the institution shall regularly apply a set of specific, predetermined stress scenarios. Such stress scenarios shall examine the effects of stress to default rates, recovery rates, credit spreads, and correlations on the profit and loss of the correlation trading desk. The institution shall apply such stress scenarios at least weekly and report at least quarterly to the competent authorities the results, including comparisons with the institution's capital charge in accordance with this point. Any instances where the stress tests indicate a material shortfall of this capital charge shall be reported to the competent authorities in a timely manner. Based on those stress testing results, the competent authorities shall consider a supplemental capital charge against the correlation trading portfolio as set out in Article 136(2) of Directive 2006/48/EC.

An institution shall calculate the capital charge to capture all price risks at least on a weekly basis.';

(e) point 6 is replaced by the following:

'6. Institutions using internal models which are not recognised in accordance with point 5 shall be subject to a separate capital charge for specific risk as calculated in accordance with Annex I.';

(f) point 7 is replaced by the following:

'7. For the purposes of points 10b(a) and (b), the results of the institution's own calculation shall be scaled up by the multiplication factors (m_c) and (m_s). Those factors shall be at least 3.';

(g) in point 8, the first paragraph is replaced by the following:

'For the purposes of points 10b(a) and (b), the multiplication factors (m_c) and (m_s) shall be increased by a plus-factor of between 0 and 1 in accordance with Table 1, depending on the number of overshootings for the most recent 250 business days as evidenced by the institution's back-testing of the value-at-risk measure as set out in point 10. The competent authorities shall require the institutions to calculate overshootings consistently on the basis of back-testing on hypothetical and actual changes in the portfolio's value. An overshooting is a one-day change in the portfolio's value that exceeds the related one-day value-at-risk measure generated by the institution's model. For the purpose of determining the plus-factor the number of overshootings shall be assessed at least quarterly and shall be equal to the higher of the number of overshootings under hypothetical and actual changes in the value of the portfolio.';

(h) point 9 is deleted;

(i) point 10 is amended as follows:

(i) point (c) is replaced by the following:

'(c) a 10-day equivalent holding period (institutions may use value-at-risk numbers calculated according to shorter holding periods scaled up to 10 days by, for example, the square root of time. An institution using that approach shall periodically justify the reasonableness of its approach to the satisfaction of the competent authorities);';

(ii) point (e) is replaced by the following:

'(e) monthly data set updates.';

(j) the following points are inserted:

'10a. In addition, each institution shall calculate a "stressed value-at-risk" based on the 10-day, 99th percentile, one-tailed confidence interval value-at-risk measure of the current portfolio, with value-at-risk model inputs calibrated to historical data from a continuous 12-month period of significant financial stress relevant to the institution's portfolio. The choice of such historical data shall be subject to approval by the competent authorities and to annual review by the institution. The Committee of European Banking Supervisors shall monitor the range of practices in this area and draw up guidelines in order to ensure convergence. Institutions shall calculate the stressed value-at-risk at least weekly.

10b. Each institution shall meet, on a daily basis, a capital requirement expressed as the sum of points (a) and (b) and an institution that uses its internal model to calculate the capital requirement for specific position risk shall meet a capital requirement expressed as the sum of points (c) and (d), as follows:

(a) the higher of:

(i) its previous day's value-at-risk number calculated in accordance with point 10 (VaR_{t-1}); and

(ii) an average of the daily value-at-risk measures in accordance with point 10 on each of the preceding sixty business days (VaR_{avg}), multiplied by the multiplication factor (m_c);

(b) the higher of:

(i) its latest available stressed-value-at-risk number in accordance with point 10a ($sVaR_{t-1}$); and

(ii) an average of the stressed value-at-risk numbers calculated in the manner and frequency specified in point 10a during the preceding sixty business days ($sVaR_{avg}$), multiplied by the multiplication factor (m_s);

(c) a capital charge calculated in accordance with Annex I for the position risks of securitisation positions and nth to default credit derivatives in the trading book with the exception of those incorporated in the capital charge in accordance with point 5l;

(d) the higher of the institution's most recent and the institution's 12 weeks average measure of incremental default and migration risk in accordance with point 5a and, where applicable, the higher of the institution's most recent and its 12-week-average measure of all price risks in accordance with point 5l.

10c. Institutions shall also carry out reverse stress tests.';

(k) in point 12, the first paragraph is replaced by the following:

'12. The risk-measurement model shall capture a sufficient number of risk factors, depending on the level of activity of the institution in the respective markets. Where a risk factor is incorporated into the institution's pricing model but not into the risk-measurement model, the institution shall be able to justify such an omission to the satisfaction of the competent authority. In addition, the risk-measurement model shall capture nonlinearities for options and other products as well as correlation risk and basis risk. Where proxies for risk factors are used they shall show a good track record for the actual position held. In addition, the following shall apply for individual risk types:'.

(4) In Annex VII, Part B is amended as follows:

(a) in point 2, point (a) is replaced by the following:

'(a) documented policies and procedures for the process of valuation, including clearly defined responsibilities of the various areas involved in the determination of the valuation, sources of market information and review of their appropriateness, guidelines for the use of unobservable inputs reflecting the institution's assumptions of what market participants would use in pricing the position, frequency of independent valuation, timing of closing prices, procedures for adjusting valuations, month end and ad-hoc verification procedures;';

(b) point 3 is replaced by the following:

'3. Institutions shall mark their positions to market whenever possible. Marking to market is the at least daily valuation of positions at readily available close out prices that are sourced independently. Examples include exchange prices, screen prices, or quotes from several independent reputable brokers.';

(c) point 5 is replaced by the following:

'5. Where marking to market is not possible, institutions shall conservatively mark to model their positions/portfolios before applying trading book capital treatment. Marking to model is defined as any valuation which has to be benchmarked, extrapolated or otherwise calculated from a market input.';

(d) in point 6, point (a) is replaced by the following:

'(a) senior management shall be aware of the elements of the trading book or of other fair-valued positions which are subject to mark to model and shall understand the materiality of the uncertainty thereby created in the reporting of the risk/performance of the business;';

(e) points 8 and 9 are replaced by the following:

'**Valuation adjustments**

8. Institutions shall establish and maintain procedures for considering valuation adjustments.

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9. The competent authorities shall require the following valuation adjustments to be formally considered: unearned credit spreads, close-out costs, operational risks, early termination, investing and funding costs, future administrative costs and, where relevant, model risk.';

(f) points 11 to 15 are replaced by the following:

'11. Institutions shall establish and maintain procedures for calculating an adjustment to the current valuation of less liquid positions. Such adjustments shall where necessary be in addition to any changes to the value of the position required for financial reporting purposes and shall be designed to reflect the illiquidity of the position. Under those procedures, institutions shall consider several factors when determining whether a valuation adjustment is necessary for less liquid positions. Those factors include the amount of time it would take to hedge out the position/risks within the position, the volatility and average of bid/offer spreads, the availability of market quotes (number and identity of market makers) and the volatility and average of trading volumes including trading volumes during periods of market stress, market concentrations, the aging of positions, the extent to which valuation relies on marking-to-model, and the impact of other model risks.

12. When using third party valuations or marking to model, institutions shall consider whether to apply a valuation adjustment. In addition, institutions shall consider the need for establishing adjustments for less liquid positions and on an ongoing basis review their continued suitability.

13. With regard to complex products including, but not limited to, securitisation exposures and n-th-to-default credit derivatives, institutions shall explicitly assess the need for valuation adjustments to reflect the model risk associated with using a possibly incorrect valuation methodology and the model risk associated with using unobservable (and possibly incorrect) calibration parameters in the valuation model.'.