

II

(Acts whose publication is not obligatory)

COMMISSION

COMMISSION RECOMMENDATION

of 22 December 1986

on monitoring and controlling large exposures of credit institutions

(87/62/EEC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community, and in particular Article 155 thereof,

Whereas the introduction of this recommendation is pursuant to the aims set out in the Commission's White Paper 'Completing the Internal Market' (¹) ;

Whereas the Advisory Committee, set up according to Article 11 of Council Directive 77/780/EEC, first Council Directive of 12 December 1977 on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions (²), assisted the Commission in the preparation of this recommendation concerning the harmonization of provisions for large exposures ;

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

Whereas credit institutions in a common banking market engage in direct competition with each other, prudential supervision requirements throughout the Community should serve to enhance confidence of the public, strengthen and protect the banking system and reduce competi-

tive distortion by introducing the gradual approximation of reporting threshold and exposure limits established and applied by the Member States ;

Whereas the system for monitoring and controlling large exposures should, on the one hand, supply the competent authorities with the data required to assess the risks and to encourage diversification and, on the other hand, provide for cooperation in applying the system between competent authorities of the Member States as well as between them and those of third countries ;

Whereas common standards for monitoring and controlling exposures of credit institutions will be introduced initially by way of a recommendation ; whereas such an instrument has been chosen since it permits existing systems to be adjusted gradually and new systems to be established without causing dislocation to the banking system of the Community ; whereas the implementation of the provisions of this recommendation will facilitate and accelerate the adoption in the near future of a directive on monitoring and controlling large exposures ;

Whereas the standards contained in this recommendation would apply to all credit institutions authorized in the Community ; whereas there exists in some Member States specific national legislation or administrative provisions which cater for the particular operating requirements of specialized credit institutions ; whereas, if such institutions are subject to similar or more restrictive provisions, the application of the abovementioned common standards may be deferred until such time as those specialized institutions are brought within the scope of this recommendation, providing such deferral does not afford to the institution a competitive advantage ;

(¹) Document COM(85) 310.

(²) OJ No L 322, 17. 12. 1977, p. 30.

Whereas, pending implementation of Council Directive 86/635/EEC on annual and consolidated accounts of banks and other financial institutions (1), and pending the harmonization of prudential returns, the accounting technique with regard to the calculation of an exposure is left to the judgment of the Member State;

Whereas an indicative list of the elements that constitute an exposure is provided for in an appendix attached to the text of the recommendation; whereas, pending further coordination, Member States may apply a discretionary weighting to the absolute value of an element; whereas Member States are expected to include all new elements which are of a broadly similar nature;

Whereas the group of connected clients is defined on the one hand according to the provisions of Council Directive 83/349/EEC (2), which now applies to banks and other financial institutions, in accordance with the abovementioned Directive 86/635/EEC, and on the other hand in terms of financial or economic interdependency;

Whereas the threshold, exposure limits and the suggested weightings prescribed in this recommendation represent an initial stage in the harmonization process, Member States may apply more stringent requirements;

Whereas the reporting period stipulated in the recommendation requires a credit institution to provide data concerning exposures at least annually; whereas it is

suggested that the competent authorities should seek a more frequent reporting in line with normal prudential requirements,

RECOMMENDS THAT THE MEMBER STATES SHOULD:

1. monitor and control the large exposures of credit institutions in accordance with the provisions contained in the attached Annex;
2. inform the Commission within 24 months of the notification of this recommendation of the texts of the main laws, regulations and administrative provisions which have been adopted with respect to this recommendation and inform the Commission of any further changes in this field.

This recommendation is addressed to the Member States.

Done at Brussels, 22 December 1986.

For the Commission
COCKFIELD
Vice-President

(1) OJ No L 372, 31. 12. 1986, p. 1.

(2) OJ No L 193, 18. 7. 1983, p. 1.

ANNEX

THE MONITORING AND CONTROL OF LARGE EXPOSURES OF CREDIT INSTITUTIONS

Article 1

Definitions

For the purpose of this recommendation :

- 'credit institution' is defined in accordance with the first indent of Article 1 of Council Directive 77/780/EEC,
- 'competent authorities' is defined in accordance with the first indent of Article 1 of Council Directive 83/350/EEC (¹),
- 'public authorities' is defined in accordance with the first indent of Article 2 of Commission Directive 80/723/EEC (²),
- 'exposure' means any facility granted, whether drawn or undrawn, by a credit institution to a client or group of connected clients, on or off balance sheet, and includes those commitments and contingent items deemed to be relevant by the respective competent authorities when assessing the identifiable risks of that institution. An indicative list of exposures is given in the Appendix to this recommendation,
- 'own funds' is defined in accordance with COM(86)169/2 (³),
- 'group of connected clients' (⁴) means two or more persons, whether natural or legal, holding exposures from the same credit institution and any of its subsidiaries, whether on a joint or separate basis, but who are mutually associated in that :
 - (i) one of them holds directly or indirectly power of control over the other as defined in Article 1 of Directive 83/349/EEC, or
 - (ii) their cumulated exposures represent to the credit institution a single risk in so much as they are so interconnected with the likelihood that if one of them experiences financial problems the other or all of them are likely to encounter repayment difficulties. By way of example of such interconnections the credit institution should take into consideration the following :

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

If such interconnections are observed it would be sound practice to assess such commitments as a single risk.

Article 2

Scope

1. Subject to paragraphs 2 and 3, this recommendation shall apply to credit institutions as defined in Article 1.
2. The Member States need not apply this recommendation to :
 - (a) credit institutions listed in Article 2 (2) of Directive 77/780/EEC as revised by Directive 86/524/EEC (⁵);
 - (b) institutions of the same Member State which, as defined in Article 2 (4) (a) of Directive 77/780/EEC, are affiliated to a central body in that Member State. In that case, without prejudice to the application of this recommendation to the central body, the whole — constituted by the central body and its affiliated institutions — must be the subject of consolidated supervision with regard to large exposures.
3. Pending further coordination, Member States may defer from the scope of this recommendation those specialized credit institutions the particular operations of which are governed by specific national legislation or administrative provisions relating, *inter alia*, to the monitoring and controlling of large exposures. These categories of credit institutions shall be reported to the Commission within six months of the notification of this recommendation.

Article 3

The reporting of large exposures

1. A report of every large exposure, as provided for under paragraph 2 and other exposures provided for under paragraph 3, if applicable, shall be made by the credit institution to the competent authorities at least annually.

(¹) OJ No L 193, 18. 7. 1983, p. 18.

(²) OJ No L 195, 29. 7. 1980, p. 35.

(³) OJ No C 243, 27. 9. 1986, p. 4.

(⁴) Although in the context of assessing exposure risk it is extremely difficult to provide an unambiguous, succinct and legally watertight definition of what constitutes a group of connected clients, it is absolutely necessary, nevertheless, for the management of a credit institution to determine whether a situation of financial, legal or economic interdependency exists between any of its customers.

(⁵) OJ No L 309, 4. 11. 1986, p. 15.

2. An exposure of a credit institution to a client or group of connected clients is considered to be a 'large exposure' when its value has reached or exceeded 15 % of own funds.

3. For those Member States not having a credit information exchange system, and for those Member States having such a system but which does not comply with the requirements in paragraph 4, and regardless of whether large exposures exist in a credit institution, the competent authorities shall require the report, mentioned in paragraph 1, to include a minimum of 10 exposures with the highest percentage value.

4. Reports which a credit institution submits to a credit information exchange system of a Member State may be considered as meeting the requirements detailed in this Article provided that :

- (i) the credit information exchange system is operated or monitored by the competent authorities or by any other public authority which reports to the competent authorities ;
- (ii) the exposures are consolidated either by the credit institution, by the credit information exchange system or by the competent authorities ;
- (iii) the data submitted to the credit information exchange system shall broadly correspond to the definition of exposure as defined in Article 1, fourth indent.

Article 4

Limits on large exposures

1. Credit institutions may not incur an exposure to a client or group of connected clients when its percentage value exceeds 40 % of own funds.

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

3. The limits referred to in paragraphs 1 and 2 may be exceeded only in exceptional circumstances and, in such cases, the competent authorities shall require the credit institution either to increase the volume of own funds or to take other remedial measures.

4. The competent authorities may fully or partially exempt from the application of paragraphs 1 and 2 the following clients or group of connected clients :

- (i) the public authorities of :

- (a) any of the Member States,
- (b) those countries on the list of industrialized countries compiled by the IMF for statistical purposes ;

(ii) The institutions of the European Communities and international public bodies of which the relevant Member State is a member.

5. The competent authorities may fully or partially exempt from the application of paragraphs 1 and 2 :

- (a) exposures secured by an explicit irrevocable guarantee or pledge of those organizations mentioned in paragraph 4 ;
- (b) exposures secured by cash deposits or listed securities, provided that the value of the latter is calculated in a prudent manner.

6. The competent authorities may exempt from the application of this recommendation 'interbank' exposures having a maturity of six months or less. Notwithstanding the limits detailed in paragraphs 1 and 2, the competent authorities may consider prescribing higher limits or an alternative weighting to the remaining 'interbank' exposures and for exposures covered by a guarantee of a credit institution.

Article 5

Third countries

1. The competent authorities of a branch having its head office in a third country may require the branch's exposures to be reported to them in order that it shall be monitored and controlled. The application of this paragraph may be subject to bilateral agreements between the respective competent authorities in order to facilitate the principle of 'home country control'.

2. Member States shall not apply to a branch of a credit institution having its head office in a third country provisions which would place the branch in a more favourable position than a branch of credit institution having its head office within the Community.

3. Application of this recommendation to credit institutions the parent undertakings of which have their head office in third countries and to credit institutions situated in third countries the parent institutions of which have a head office in the Community may be the subject of bilateral agreements, on the basis of reciprocity, between the competent authorities of the Member States and the third country concerned. Such agreements shall seek to ensure that Member States' competent authorities are able to obtain the necessary information to enable the large exposures of a credit institution within the Community, with participations outside the Community, to be monitored and controlled and that the competent authorities in a third country are able to obtain the necessary information to enable parent companies having head offices within their territory, which have participations in credit institutions situated in one or more Member States, to be supervised.

4. Prior to entering into negotiations in connection with agreements with third countries the Member States shall inform the Commission and the Advisory Committee set up under Article 11 of Directive 77/780/EEC. The Commission shall undertake the coordination of the policy objectives pursued in such negotiations for which purpose it may seize the Advisory Committee.

Article 6

Consolidation

1. The exposures of a credit institution which has a participation, as defined in Article 1, indent 3, of Directive 83/350/EEC, in another credit institution or financial institution shall be monitored and controlled on a consolidated basis to the extent and in manner according to the requirements prescribed by the Member State in applying Directive 83/350/EEC.

2. In addition to the requirements of paragraph 1, the competent authorities of a Member State may also monitor and control the exposures of individual credit institutions on a partially consolidated or non-consolidated basis.

Article 7

Facilitating measures

1. Member States shall ensure that there are no legal impediments preventing any credit or financial institution from supplying to a credit institution which has a participation in it information which is necessary for monitoring and controlling large exposures in accordance with this recommendation.

2. Member States shall permit the exchange between their competent authorities of the information necessary for monitoring and controlling the large exposures to be effected in accordance with this recommendation, it being understood that, in the case of financial institutions, the collection or possession of information shall not in any

way imply that a supervisory function is being exercised over those financial institutions by the competent authorities.

3. Any exchange of information between competent authorities which is provided for in this recommendation shall be subject to the obligation of professional secrecy as set out in Article 12 of Directive 77/780/EEC; any such information shall be used exclusively for the purposes of monitoring and controlling the solvency of the relevant credit institution.

4. If, in applying this recommendation to a credit institution, the competent authorities of one Member State wish in specific cases to verify the information concerning a credit or financial institution in another Member State, they must ask the competent authorities of that other Member State for this verification to be carried out. The authorities which have received the request must, within the framework of their competence, act upon it either by carrying out the verification themselves, or by allowing the authorities which made the request to carry it out, or by allowing an auditor or expert to carry it out.

Article 8

Transitional provisions relating to exposures in excess of the limits

1. Where, at the time of entry into effect of the measures taken in applying this recommendation, a credit institution has already incurred an exposure or exposures exceeding either the large exposure limit or the aggregate large exposure limit, as referred to in Article 4, the competent authorities shall take steps to bring into line the exposure or exposures of the credit institutions concerned in accordance with the provisions of this recommendation.

2. The process to bring into line the exposure or exposures should be drawn up, adopted, implemented and completed within the time the competent authorities deem it prudentially sound and competitively fair. The competent authorities shall inform the Commission of the time schedule of the general implementation process adopted.

*Appendix***DEFINITION OF THE TERM 'EXPOSURE'****Supplementary information**

The items detailed below are an indicative list of elements which a Member State may consider including within the term 'exposure'. Pending further coordination, the Member States have discretion to fix the weighted value of the elements listed below; however, the Commission recommends that those elements contained in sections A and B (i) be weighted at 100 %. Since the list is indicative, and therefore it is not considered comprehensive, the Commission would expect Member States to include in the term 'exposure' any elements which are of broadly similar character.

A. On-balance-sheet items :

- Loans and advances, including overdrafts,
- Bill and promissory notes,
- Leases,
- Shares and other securities,
- Loan stocks,
- Certificates of deposits.

B. Off-balance-sheet items :**(i) Guarantees and similar contingent liabilities :**

- Acceptances,
- Endorsements on bills which do not carry the name of another credit institution,
- Guarantees which take the form of credit substitutes,
- Documentary credits, issued and confirmed,
- Transactions with recourse,
- Warrantees and indemnities, including tender and performance bonds and customs and tax bonds,
- Irrevocable standby letters of credit ;

(ii) Commitments :

- Asset sale and repurchase agreements,
- Assets purchased under outright forward purchase agreements,
- Unpaid portion of partly-paid shares and securities,
- Standby facilities, such as irrevocable revolving lines of credit,
- Underwriting, including note issuance facilities and revolving underwriting facilities,
- Irrevocable undrawn overdraft facilities, commitments to lend, purchase securities or provide guarantees or acceptance facilities.
