I

(Resolutions, recommendations and opinions)

OPINIONS

EUROPEAN CENTRAL BANK

OPINION OF THE EUROPEAN CENTRAL BANK

of 12 November 2009

on a proposal for a Directive of the European Parliament and of the Council 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

(CON/2009/94)

(2009/C 291/01)

Introduction and legal basis

1. On 10 September 2009 the European Central Bank (ECB) received a request from the Council of the European Union for an opinion on a proposal for a directive of the European Parliament and of the Council 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 [1] (hereinafter the 'proposed directive').

2. The ECB's competence to deliver an opinion is based on the first indent of Article 105(4) of the Treaty establishing the European Community and on Article 105(5) of the Treaty, as the proposed directive concerns one of the tasks of the European System of Central Banks (ESCB), namely to contribute to the smooth conduct of policies pursued by the competent authorities relating to the stability of the financial system. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

General observations

3. The ECB welcomes the proposed directive as regards capital requirements for bank trading books and for re-securitisations, which are broadly consistent with the approach recently developed by the Basel Committee on Banking Supervision [2]. The ECB is of the view that there is the need to further align the requirements of the proposed directive to the revised Basel II market risk framework. In particular, the ECB suggests introducing in Annex II point (1) of the proposed directive an exemption for correlation trading activities from the requirement that all securitisation exposures in the trading book receive the standardised specific risk treatment.

4. Furthermore, the ECB notes that the quantitative impact study currently being conducted by the Basel Committee on Banking Supervision may lead to recalibration of 'correlation trading activities'. Should the

[1] COM(2009) 362 final.

[2] See the Basel Committee on Banking Supervision's 'Revisions to the Basel II market risk framework', 'Guidelines for computing capital for incremental risk in the trading book', and 'Enhancements to the Basel II framework', dated 13 July 2009, available on the Bank for International Settlements' website at http://www.bis.org

impact study indeed lead to the recalibration of the Basel II market risk framework, the ECB strongly supports making a corresponding alignment of the proposed directive, or any amendment to it, in order to ensure fair international competition in this area.

5. The ECB also welcomes the introduction of remuneration provisions in Annex I to the proposed directive, which are in line with the commitment of the G20 leaders to implement international compensation standards aimed at ending practices that lead to excessive risk-taking ([1]). Moreover, the ECB supports the application of the provisions for remuneration policies at the group level, to ensure consistent treatment of risk-taking employees in all jurisdictions where EU banks operate. Finally, the ECB highlights that when introducing international standards that primarily address significant financial institutions into Community law, which applies to all credit institutions (including small ones), the proportionality principle, as laid down in the Treaty, should be applied appropriately.

6. Where the ECB recommends amending the proposed directive, specific drafting proposals are set out in the Annex accompanied by an explanation. These proposals do not address the more general observations made above.

Done at Frankfurt am Main, 12 November 2009.

The President of the ECB

Jean-Claude TRICHET

([1]) See 'FSF Principles for Sound Compensation Practices' and the relevant implementation standards, available on the G20 website at http://www.g20.org

ANNEX

Drafting proposals

Text proposed by the Commission	Amendments proposed by the ECB [1]

Amendment 1

Citations

'Having regard to the Treaty establishing the European Community, and in particular Article 47(2) thereof, Having regard to the proposal from the Commission, Having regard to the opinion of the European Economic and Social Committee, Acting in accordance with the procedure laid down in Article 251 of the Treaty,'	'Having regard to the Treaty establishing the European Community, and in particular Article 47(2) thereof, Having regard to the proposal from the Commission, Having regard to the opinion of the European Economic and Social Committee, **Having regard to the opinion of the European Central Bank**, Acting in accordance with the procedure laid down in Article 251 of the Treaty,'

Explanation:

Since the Treaty requires consultation of the ECB on the proposed directive, a citation to this effect should be inserted in the proposed directive in line with Article 253 of the Treaty.

Amendment 2

Article 1(9)

'Article 122b 1. Notwithstanding the risk weights for general re-securitisation positions in Annex IX, Part 4, the competent authorities shall require that credit institutions apply a 1 250 % risk weight to positions in highly complex re-securitisations, unless the credit institution has demonstrated to the competent authority for each such re-securitisation position concerned that it has complied with the requirements set out in Article 122a(4) and (5). 2. Paragraph 1 shall apply in respect of positions in new re-securitisations issued after 31 December 2010. In respect of positions in existing re-securitisations, paragraph 1 shall apply from 31 December 2014 where new underlying exposures are added or substituted after that date.'	'~~Article 122b~~ ~~1. Notwithstanding the risk weights for general re-securitisation positions in Annex IX, Part 4, the competent authorities shall require that credit institutions apply a 1 250 % risk weight to positions in highly complex re-securitisations, unless the credit institution has demonstrated to the competent authority for each such re-securitisation position concerned that it has complied with the requirements set out in Article 122a(4) and (5)~~. ~~2. Paragraph 1 shall apply in respect of positions in new re-securitisations issued after 31 December 2010. In respect of positions in existing re-securitisations, paragraph 1 shall apply from 31 December 2014 where new underlying exposures are added or substituted after that date~~.'

Explanation:

The issue of non-compliance with due diligence requirements for securitisation exposures is adequately addressed by Article 122a of the Directive adopted by the Council on 15 July 2009 [2]. Furthermore, the proposed treatment of highly complex re-securitisation exposures under proposed Article 122b is not in line with the proportionality principle applied in Article 122a(5) of the abovementioned Directive, which provided for a range of 250 % to 1 250 %, depending on the level of infringement of the due diligence provisions. As a consequence, the ECB suggests deleting the proposed Article 122b.

Text proposed by the Commission	Amendments proposed by the ECB (1)

Amendment 3

Annex I, paragraph 1

Text proposed by the Commission	Amendments proposed by the ECB
'11. REMUNERATION POLICIES	'11. REMUNERATION POLICIES
22. When establishing and applying the remuneration policies for those categories of staff whose professional activities have a material impact on their risk profile, credit institutions shall comply with the following principles in a way that is appropriate to their size, internal organisation and the nature, the scope and the complexity of their activities:	22. When establishing and applying the remuneration policies for those categories of staff whose professional activities have a material impact on their risk profile, credit institutions shall comply with the following principles in a way 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;	(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;	(b) the remuneration policy is in line with the business strategy, objectives, values and long-term interests of the credit institution;
(c) the management body (supervisory function) of the credit institution establishes the general principles of the remuneration policy and is responsible for its implementation;	(c) the management body (supervisory function) of the credit institution establishes **and 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 defined by the management body (supervisory function);	(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 defined by the management body (supervisory function);
(e) 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;	**(e) the remuneration of staff engaged in financial and risk control is independent of the business areas they oversee and commensurate with their key role in the credit institution;**
(f) fixed and variable components of total remuneration are appropriately balanced; the fixed component represents a sufficiently high proportion of the total remuneration to allow the operation of a fully flexible bonus policy, including the possibility to pay no bonus;	(~~e~~**f**) ~~W~~**w**here 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;
(g) 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;	(~~h~~**g**) the measurement of performance used to calculate **the variable remuneration component** ~~bonuses or bonus pools~~ includes an adjustment for **all types of** current and future risks and takes into account the cost of the capital and the liquidity required;

Text proposed by the Commission	Amendments proposed by the ECB [1]
(h) the measurement of performance used to calculate bonuses or bonus pools includes an adjustment for current and future risks and takes into account the cost of the capital and the liquidity required;	**(h) guaranteed variable remuneration may only occur in exceptional cases in the context of hiring new staff and is limited to the first year, taking due account of prudent risk management policies;**
(i) payment of the major part of a significant bonus is deferred for an appropriate period and is linked to the future performance of the firm.'	(~~f~~**i**) ~~F~~fixed and variable components of total remuneration are appropriately balanced **and consistent with risk alignment**; the fixed component represents a sufficiently high proportion of the total remuneration to allow the operation of a fully flexible bonus policy **with regard to the variable component**, including the possibility to pay no ~~bonus~~ **variable component**;
	(j) payment of the total variable remuneration does not limit the ability of the credit institution to strengthen its capital base;
	(~~i~~**k**) payment of the major part of a significant **variable remuneration component** ~~bonus~~ is deferred for an appropriate period **of no less than three years, is vested no faster than on a pro rata basis**, and is linked to the future performance of the **credit institution;**~~firm~~.
	(l) a substantial proportion of the variable remuneration component should be awarded in shares or share-linked instruments, or, where appropriate, other non-cash instruments as long as these instruments create incentives aligned with long-term value creation and the time horizons of risk. Awards in shares, share-linked or other non-cash instruments are subject to an appropriate retention policy;
	(~~g~~**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~~;~~.
	22a. Credit institutions that are significant in terms of their size, internal organisation and the nature, scope and complexity of their activities shall establish a board remuneration committee to oversee their compensation policies and practices. The remuneration committee shall be constituted in a way that enables it to exercise competent and independent judgement on remuneration policies and practices and the incentives created for managing risk, capital and liquidity.'

Text proposed by the Commission	Amendments proposed by the ECB [1]

Explanation:

The ECB suggests amending Annex I, paragraph 1 of the proposed directive as follows: (i) measurement of performance should be adjusted for all types of risk (see point g of the right column above); and (ii) points h and i of Annex 1, paragraph 1 of the proposed directive should be reshuffled (see points g and i of the right column above) in order to keep together the references to the measurement of performance and to the variable remuneration component. Finally, the ECB proposes the introduction of new principles reflecting the agreement of the G20 leaders reached at the Pittsburgh Summit on 24-25 September 2009. In particular, the G20 leaders fully endorsed the implementation standards of the Financial Stability Board aimed at aligning compensation with long-term value creation, not excessive risk-taking (see footnote 3 above).

Amendment 4

Annex II, paragraph 3(e)

'7. For the purposes of points 10b(a) and 10b(b), the results of the institution's own calculation shall be scaled up by a multiplication factor (m+) of at least 3.'	'7. For the purposes of points 10b(a) and 10b(b), the results of the institution's own calculation shall be scaled up by a multiplication factor ($m_{\mathbf{c}}\cancel{+}$) of at least 3 **and a multiplication factor (m_s) of at least 3**.'

Explanation:

The ECB supports the alignment of the proposed directive with the relevant Basel text (i.e. Revisions to the Basel II market risk framework) that provides for two different multipliers for current and stressed value-at-risk.

Amendment 5

Annex II, paragraph 3(f)

'For the purposes of point 10b(a) and 10b(b), the multiplication factor (m+) 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 […].'	'For the purposes of point 10b(a) and 10b(b), the multiplication factor**s** ($m_{\mathbf{c}}\cancel{+}$) **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 […].'

Explanation:

See the explanation for Amendment 4.

(1) Bold in the body of the text indicates where the ECB proposes inserting new text. Strikethrough in the body of the text indicates where the ECB proposes deleting text.

(2) Directive of the European Parliament and of the Council amending Directives 2006/48/EC, 2006/49/EC and 2007/64/EC as regards banks affiliated to central institutions, certain own funds items, large exposures, supervisory arrangements, and crisis management, adopted by the Council on 15 July 2009, following an agreement reached with the European Parliament in first reading, available on the Council's website at http://register.consilium.europa.eu