EUROPEAN MONETARY INSTITUTE

OPINION OF THE EUROPEAN MONETARY INSTITUTE

**Consultation from the Council of the European Union under Article 109f (6) of the Treaty establishing the European Community (the "Treaty")
on a Commission Proposal for a European Parliament and Council Directive (EC)
amending Council Directive 93/6/EEC
on the capital adequacy of investment firms and credit institutions**

CON/97/14

1. On 4 July 1997 the EMI received from the Council of the European Union the request for an opinion on a Commission Proposal for a European Parliament and Council Directive (EC) amending Council Directive 93/6/EEC on the capital adequacy of investment firms and credit institutions. The Council of the European Union transmitted for this purpose document COM(97) 71 final, containing the text of the proposal and the explanatory memorandum.

2. The EMI considers that this consultation is not optional as it was stated by the Council. The present proposal relates to the field of competence of the EMI. It concerns inter alia the supervision of credit institutions and investment firms, an area which falls within the competence of a number of national central banks. This activity could have a potential impact upon the stability of financial institutions and financial markets.

3. The EMI notes the objective of the proposal to allow the use of internal risk management models for the calculation of capital requirements for market risks and the inclusion of a framework for specific capital requirements for market risks inherent in commodity trading and commodity derivatives business. It is also noted that by the proposed amendments to Directive 93/6/EEC the Commission has discharged its obligation laid down in Article 13 of that Directive to submit to the Council proposals for the capital requirements in respect of commodities trading and commodity derivatives. In line with Article 14 of Directive 93/6/EEC, the Commission proposes to reflect in the European legislation amendments to the Basle Capital Accord of 1988 which have been issued by the Basle Committee on Banking Supervision in January 1996 and which will come into effect by end of 1997.[1] The EMI takes note of the other minor proposed changes aiming at clarification of certain provisions of the Directive.

[1] See "Overview of the Amendment to the Capital Accord to incorporate market risks", "Amendment to the Capital Accord to incorporate market risks", and "Supervisory framework for the use of 'backtesting' in

4. The EMI welcomes the proposal. The EMI hopes that the positive effects on the stability of the financial system which are expected to be triggered by the proposal will materialise. The use of results of institutions' internal models for the calculation of supervisory capital requirements should give institutions an incentive to employ accurate risk measurement and management methods. The regular backtesting of these results will ideally prove to turn out to be an efficient procedure for the on-going re-assessment of the performance of the internal models and will contribute to their upgrade and development. The inclusion of a specific framework of capital requirements for commodity business carried out by credit institutions and investment firms into the Directive 93/6/EEC is welcomed by the EMI.

The EMI welcomes the fact that the draft will bring EU legislation in line with the amended Basle Capital Accord of 1988 and will thus maintain a level regulatory playing field in a wider international context. The EMI recognises the competitive aspects of the regulatory framework to which reference is made in the fourth whereas clause of the draft proposal and the ensuing need for a rapid adoption of the proposed legislation. In this context, the EMI wishes to point out that many of the proposed amendments are of technical nature and that further amendments of the Basle Capital Accord cannot be ruled out for the future. It will therefore be of importance for the EU financial sector that changes to technical details of the Directive can be made flexibly and speedily. In order to provide for this, the EMI recommends that the Council considers the appropriateness of wording which specifies areas of the Directive which could be changed by conferring implementation powers on the Commission (comitology). Moreover, in case that such amendments to the Basle Capital Accord will be decided upon at a time where the adoption of this draft directive is still pending, the EMI wishes to encourage the Council to work towards taking account of such developments still in this legislative procedure, whenever this is procedurally possible.

5. Apart from these general observations the following specific aspects may be considered by the Council. First, the EMI notes that Article 7 of Directive 93/6/EEC in combination with the amended Article 4 of Directive 93/6/EEC will govern the supervision on a consolidated basis of capital requirements for market risk. The interplay between the use of internal models according to the new Annex VIII and the application of capital requirements on a consolidated basis may usefully be studied in more detail in the future on the basis of experience gained in the practice. Similarly, there may be merit in studying and clarifying the interplay between the use of internal models and the application of the large exposure rules set out in the Capital Adequacy Directive. Second, the definition of "stock financing" may be clarified. Distinguishing between the practice

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conjunction with the internal models approach to market risk capital requirements", Basle Committee on Banking Supervision, Bank for International Settlements, Basle 1996 of stock financing and the resulting positions could be helpful. Notwithstanding the eighth recital of the draft Directive that refers to the specific case of certain investment firms dealing primarily in commodities and commodity derivatives, the EMI, lastly, notes that the transitional rule under Article 12a, that applies to investment firms only, might give rise to the question of justifying the different treatment.

6. This opinion will be published in the Official Journal of the European Communities.

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