

GUIDELINES

GUIDELINE (EU) 2017/697 OF THE EUROPEAN CENTRAL BANK

of 4 April 2017

on the exercise of options and discretions available in Union law by national competent authorities in relation to less significant institutions (ECB/2017/9)

THE GOVERNING COUNCIL OF THE EUROPEAN CENTRAL BANK,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions ⁽¹⁾, and in particular Article 6(1), and Article 6(5)(a) and (c) thereof,

Whereas:

- (1) The European Central Bank (ECB) is responsible for the effective and consistent functioning of the Single Supervisory Mechanism (SSM). It oversees the functioning of the system to ensure the consistent application of high supervisory standards and the consistency of supervisory outcomes across the participating Member States. The ECB may issue guidelines to national competent authorities (NCAs), in accordance with which supervisory tasks are to be performed and supervisory decisions are to be adopted by NCAs.
- (2) The ECB has to ensure the consistent application of prudential requirements for credit institutions within the participating Member States, under Regulation (EU) No 1024/2013 and Regulation (EU) No 468/2014 of the European Central Bank (ECB/2014/17) ⁽²⁾.
- (3) As the competent authority to do so under Regulation (EU) No 1024/2013, the ECB has exercised a number of options and discretions available in Union law under Regulation (EU) 2016/445 of the European Central Bank (ECB/2016/4) ⁽³⁾ for credit institutions that are classified as significant.
- (4) Although NCAs are primarily responsible for exercising the relevant options and discretions in relation to less significant institutions, the ECB's overarching oversight role within the SSM enables it to promote the consistent exercise of options and discretions in relation to both significant and less significant institutions, where appropriate. This ensures that: (a) the prudential supervision of all credit institutions in the participating Member States is implemented in a coherent and effective manner; (b) the single rulebook for financial services is applied consistently to all credit institutions in the participating Member States; and (c) that all credit institutions are subject to supervision of the highest quality.
- (5) With the aim of balancing the need for the consistent application of supervisory standards between significant and less significant institutions on the one hand with the application of the principle of proportionality on the other hand, the ECB has identified certain options and discretions among those it exercised in Regulation (EU) 2016/445 (ECB/2016/4) which should be exercised in the same way by NCAs in the supervision of less significant institutions.

⁽¹⁾ OJ L 287, 29.10.2013, p. 63.

⁽²⁾ Regulation (EU) No 468/2014 of the European Central Bank of 16 April 2014 establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and national competent authorities and with national designated authorities (SSM Framework Regulation) (ECB/2014/17) (OJ L 141, 14.5.2014, p. 1).

⁽³⁾ Regulation (EU) 2016/445 of the European Central Bank of 14 March 2016 on the exercise of options and discretions available in Union law (ECB/2016/4) (OJ L 78, 24.3.2016, p. 60).

- (6) Options and discretions granted to competent authorities with reference to own funds and capital requirements under Article 89(3), Article 178(1)(b) and Article 282(6) of Regulation (EU) No 575/2013 of the European Parliament and of the Council ⁽¹⁾, as well as under the transitional provisions provided for in Article 471(1) and Article 478(3)(a) and (b) of the same Regulation, have an impact on the level and quality of regulatory own funds and the capital ratios of less significant institutions. A prudent and consistent application of these options and discretions is necessary for several reasons. It will ensure that: (a) the risks related to qualifying holdings outside the financial sector are adequately addressed; (b) the definition of default is used in a consistent manner with regard to the adequacy and comparability of own funds requirements; and (c) that own funds requirements for transactions with a non-linear risk profile or for payment legs and transactions with debt instruments as underlying for which the institution cannot determine the delta or the modified duration are calculated in a prudent way. The harmonised application of transitional provisions related to the deduction of equity holdings in insurance companies and deferred tax assets will ensure that the more rigorous definition of regulatory capital introduced by Regulation (EU) No 575/2013 is implemented by all credit institutions in the participating Member States within an adequate period of time.
- (7) Options and discretions in relation to the exemption of exposures from the application of the large exposure limits set out in Article 395(1) of Regulation (EU) No 575/2013 should be consistently applied to both significant institutions and less significant institutions to establish a level playing field for credit institutions in the participating Member States, limit concentration risks arising from specific exposures, and ensure that the same minimum standards are applied across the SSM for the assessment of compliance with the conditions specified in Article 400(3) of the same Regulation. In particular, concentration risks arising from covered bonds falling within the terms of Article 129(1), (3) and (6) of Regulation (EU) No 575/2013 and exposures to or guaranteed by regional governments or local authorities of Member States, where those claims would be assigned a 20 % risk weight under Part Three, Title II, Chapter 2 of Regulation (EU) No 575/2013, should be limited. For intragroup exposures, including participations or other kinds of holdings, it needs to be ensured that the decision to fully exempt these exposures from the application of the large exposure limits is based on a thorough assessment as specified in Annex I to Regulation (EU) 2016/445 (ECB/2016/4). The application of common criteria for the assessment of whether an exposure, including participations or other kinds of holdings, to regional or central credit institutions with which the credit institution is associated in a network in accordance with legal or statutory provisions and which are responsible, under those provisions, for cash-clearing operations within the network, meets the conditions for an exemption from the large exposure limits as specified in Annex II to Regulation (EU) 2016/445 (ECB/2016/4) is warranted. Such application should ensure that significant and less significant institutions associated in the same network are treated in a consistent way. The exercise of the option provided for in Article 400(2) of Regulation (EU) No 575/2013 as set out in this Guideline should only apply if the relevant Member State has not exercised the option provided for in Article 493(3) of Regulation (EU) No 575/2013.
- (8) Options and discretions granted to competent authorities under Article 24(4) and (5) of Commission Delegated Regulation (EU) 2015/61 ⁽²⁾ for the calculation of outflows from stable retail deposits covered by a deposit guarantee scheme (DGS) in order to calculate liquidity coverage requirements should be consistently exercised for significant and less significant institutions in order to ensure identical treatment of credit institutions in the same DGS,

HAS ADOPTED THIS GUIDELINE:

CHAPTER I

GENERAL PROVISIONS

Article 1

Subject matter and scope

This Guideline specifies certain of the options and discretions of general application conferred on competent authorities under Union law concerning prudential requirements, the exercise of which by the NCAs in relation to the less significant institutions shall be fully aligned to the ECB's exercise of the relevant options and discretions in Regulation (EU) 2016/445 (ECB/2016/4).

⁽¹⁾ Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1).

⁽²⁾ Commission Delegated Regulation (EU) 2015/61 of 10 October 2014 to supplement Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to liquidity coverage requirement for credit institutions (OJ L 11, 17.1.2015, p. 1).

*Article 2***Definitions**

For the purposes of this Guideline, the definitions contained in Article 4 of Regulation (EU) No 575/2013, Article 2 of Regulation (EU) No 1024/2013, Article 2 of Regulation (EU) No 468/2014 (ECB/2014/17) and Article 3 of Delegated Regulation (EU) 2015/61 shall apply.

CHAPTER II

**EXERCISE OF OPTIONS AND DISCRETIONS IN RELATION TO LESS SIGNIFICANT INSTITUTIONS
REQUIRING FULL ALIGNMENT WITH THE LAW APPLICABLE TO SIGNIFICANT INSTITUTIONS**

SECTION I

Own funds

*Article 3***Article 89(3) of Regulation (EU) No 575/2013: risk weighting and prohibition of qualifying holdings outside the financial sector**

Without prejudice to Article 90 of Regulation (EU) No 575/2013 and for the purpose of calculating the capital requirements in accordance with Part Three of Regulation (EU) No 575/2013, NCAs shall require less significant institutions to apply a risk weight of 1 250 % to the greater of the following:

- (a) the amount of qualifying holdings in undertakings referred to in Article 89(1) of Regulation (EU) No 575/2013 in excess of 15 % of the eligible capital of the credit institution; and
- (b) the total amount of qualifying holdings in undertakings referred to in Article 89(2) of Regulation (EU) No 575/2013 that exceeds 60 % of the eligible capital of the credit institution.

SECTION II

Capital requirements

*Article 4***Article 178(1)(b) of Regulation (EU) No 575/2013: default of an obligor**

NCAs shall require less significant institutions to apply the 'more than 90 days past due' standard for the categories of exposures specified in Article 178(1)(b) of Regulation (EU) No 575/2013.

*Article 5***Article 282(6) of Regulation (EU) No 575/2013: hedging sets**

For the transactions referred to in Article 282(6) of Regulation (EU) No 575/2013, NCAs shall require less significant institutions to use the mark-to-market method set out in Article 274 of Regulation (EU) No 575/2013.

SECTION III

Large exposures

*Article 6***Article 400(2) of Regulation (EU) No 575/2013: exemptions**

NCAs shall exercise the option with regard to exemptions provided for in Article 400(2) of Regulation (EU) No 575/2013 in relation to less significant institutions in accordance with this Article and the Annex.

- (a) The exposures listed in Article 400(2)(a) of Regulation (EU) No 575/2013 shall be exempted from the application of Article 395(1) of that Regulation for 80 % of the nominal value of the covered bonds, provided that the conditions set out in Article 400(3) of that Regulation are fulfilled.
- (b) The exposures listed in Article 400(2)(b) of Regulation (EU) No 575/2013 shall be exempted from the application of Article 395(1) of that Regulation for 80 % of their exposure value, provided that the conditions set out in Article 400(3) of that Regulation are fulfilled.
- (c) The exposures listed in Article 400(2)(d) of Regulation (EU) No 575/2013 shall be exempted in full from the application of Article 395(1) of that Regulation, provided that the conditions set out in Article 400(3) of that Regulation, as further specified in the Annex to this Guideline, are fulfilled.
- (d) The exposures listed in Article 400(2)(e) to (k) of Regulation (EU) No 575/2013 shall be exempted in full, or in the case of Article 400(2)(i) they shall be exempted up to the maximum allowed amount, from the application of Article 395(1) of that Regulation, provided that the conditions set out in Article 400(3) of that Regulation are fulfilled.
- (e) NCAs shall require less significant institutions to assess whether the conditions specified in Article 400(3) of Regulation (EU) No 575/2013, as well as in the Annex to this Guideline applicable to the specific exposure, are fulfilled. The NCA may verify this assessment at any time and request less significant institutions to submit the documentation referred to in the Annex for this purpose.
- (f) This Article shall only apply where the relevant Member State has not exercised the option under Article 493(3) of Regulation (EU) No 575/2013 to grant a full or partial exemption for the specific exposure.

SECTION IV

Liquidity

*Article 7***Article 24(4) and (5) of Delegated Regulation (EU) 2015/61: outflows from stable retail deposits**

NCAs shall require less significant institutions to multiply by 3 % the amount of stable retail deposits covered by a deposit guarantee scheme as referred to in Article 24(4) of Delegated Regulation (EU) 2015/61, provided that the Commission has given its prior approval in accordance with Article 24(5) of that Delegated Regulation certifying that all the conditions of Article 24(4) have been fulfilled.

SECTION V

Transitional provisions of Regulation (EU) No 575/2013

*Article 8***Article 471(1) of Regulation (EU) No 575/2013: exemption from deduction of equity holdings in insurance companies from Common Equity Tier 1 items**

1. During the period from 1 January to 31 December 2018, NCAs may permit less significant institutions not to deduct equity holdings in insurance undertakings, reinsurance undertakings and insurance holding companies from Common Equity Tier 1 items in accordance with Article 471(1) of Regulation (EU) No 575/2013.

2. From 1 January 2019, NCAs shall require less significant institutions to deduct equity holdings in insurance undertakings, reinsurance undertakings and insurance holding companies from Common Equity Tier 1 items.
3. This Article applies without prejudice to decisions taken by the NCAs pursuant to Article 49(1) of Regulation (EU) No 575/2013.

Article 9

Article 478(3)(a) and (b) of Regulation (EU) No 575/2013: applicable percentages for deduction from Common Equity Tier 1 items of significant investments in financial sector entities and deferred tax assets that rely on future profitability

NCAs shall exercise the option with regard to the applicable percentages for deduction from Common Equity Tier 1 items of significant investments in financial sector entities and deferred tax assets that rely on future profitability provided for in Article 478(3)(a) and (b) of Regulation (EU) No 575/2013 as follows:

- (a) for the purposes of Article 478(1) of Regulation (EU) No 575/2013, the applicable percentage for the purposes of Article 469(1)(a) and (c) of that Regulation shall be 100 % from 1 January 2018;
- (b) for the purposes of Article 478(2) of Regulation (EU) No 575/2013, the applicable percentage shall be 100 % from 1 January 2018;
- (c) by way of derogation from point (b), where, pursuant to Article 478(2) of Regulation (EU) No 575/2013, national law provides for a 10-year phase-out period, the applicable percentage shall be:
 - (i) 80 % during the period from 1 January to 31 December 2018; and
 - (ii) 100 % from 1 January 2019;
- (d) NCAs shall not apply points (b) and (c) to less significant institutions which, on the date on which this Guideline takes effect, are subject to restructuring plans approved by the Commission;
- (e) where a credit institution falling within the scope of point (d) is acquired by or merges with another credit institution while the restructuring plan is still in operation without modification concerning the prudential treatment of deferred tax assets, NCAs shall apply the exception in point (d) to the acquiring credit institution, new credit institution resulting from the merger or credit institution incorporating the original credit institution, to the same extent that it applied to the acquired, merged or incorporated credit institution;
- (f) in the event of an unforeseen increase in the impact of the deductions provided for in points (b) and (c) which the NCA determines is material, less significant institutions shall be allowed not to apply points (b) or (c);
- (g) where points (b) and (c) do not apply, NCAs shall require less significant institutions to apply national legislative provisions;

This Article is without prejudice to national law existing prior to the date on which this Guideline takes effect, provided that such law sets percentages that are higher than those specified in points (a) to (c).

CHAPTER III

FINAL PROVISIONS

Article 10

Taking effect and implementation

1. This Guideline shall take effect on the day following that of its publication in the *Official Journal of the European Union*.

2. The NCAs shall comply with this Guideline from 1 January 2018, except for Article 7 which they shall comply with from 1 January 2019.

Article 11

Addressees

This Guideline is addressed to the NCAs of participating Member States.

Done at Frankfurt am Main, 4 April 2017.

For the Governing Council of the ECB
The President of the ECB
Mario DRAGHI

ANNEX

Conditions for assessing an exemption from the large exposure limit, in accordance with Article 400(2)(d) of Regulation (EU) No 575/2013 and Article 6(c) of this Guideline

1. NCAs shall require less significant institutions to take the following criteria into account when assessing whether an exposure referred to in Article 400(2)(d) of Regulation (EU) No 575/2013 meets the conditions for an exemption from the large exposure limit, in accordance with Article 400(3) of Regulation (EU) No 575/2013.
 - (a) for the purpose of assessing whether the specific nature of the exposure, the regional or central body or the relationship between the credit institution and the regional or central body eliminate or reduce the risk of the exposure, as provided for in Article 400(3)(a) of Regulation (EU) No 575/2013, less significant institutions must take into account whether:
 - (i) there are any current or anticipated material practical or legal impediments that would hinder the timely repayment of the exposure by the counterparty to the credit institution, other than in the event of a recovery or resolution situation, when the restrictions outlined in Directive 2014/59/EU of the European Parliament and of the Council ⁽¹⁾ are required to be implemented;
 - (ii) the proposed exposures are in line with the credit institution's ordinary course of business and its business model or justified by the funding structure of the network;
 - (iii) the process by which a decision is made to approve an exposure to the credit institution's central body, and the monitoring and review process applicable to such exposures, at individual level and at consolidated level, where relevant, are similar to those that are applied to third-party lending;
 - (iv) the credit institution's risk management procedures, IT system and internal reporting enable it to continuously check and ensure that the large exposures to its regional or central body are compatible with its risk strategy;
 - (b) for the purpose of assessing whether any remaining concentration risk can be addressed by other equally effective means such as the arrangements, processes and mechanisms provided for in Article 81 of Directive 2013/36/EU of the European Parliament and of the Council ⁽²⁾, as provided for in Article 400(3)(b) of Regulation (EU) No 575/2013, less significant institutions must take into account whether:
 - (i) the credit institution has robust processes, procedures and controls to ensure that use of the exemption would not result in concentration risk which is outside its risk strategy;
 - (ii) the credit institution has formally considered the concentration risk arising from exposures to its regional or central body as part of its overall risk assessment framework;
 - (iii) the credit institution has a risk control framework that adequately monitors the proposed exposures;
 - (iv) the concentration risk arising has been or will be clearly identified in the credit institution's internal capital adequacy assessment process (ICAAP) and will be actively managed. The arrangements, processes and mechanisms to manage the concentration risk will be assessed in the supervisory review and evaluation process.
2. In addition to the conditions set out in paragraph 1, NCAs shall require less significant institutions to take into account, for the purpose of assessing whether the regional or central body with which the credit institution is associated in a network is responsible for cash-clearing operations, as provided for in Article 400(2)(d) of Regulation (EU) No 575/2013, whether the by-laws or articles of association of the regional or central body explicitly contain such responsibilities, including, but not limited to the following:
 - (a) market funding for the whole network;

⁽¹⁾ Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council (OJ L 173, 12.6.2014, p. 190).

⁽²⁾ Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338).

- (b) clearing liquidity within the network, within the scope of Article 10 of Regulation (EU) No 575/2013;
 - (c) providing liquidity to affiliated credit institutions;
 - (d) absorbing excess liquidity of affiliated credit institutions.
3. For the purposes of verifying whether the conditions specified in paragraph 1 and 2 are met, NCAs may request less significant institutions to submit the following documentation.
- (a) a letter signed by the credit institution's legal representative, with approval from the management body, stating that the credit institution complies with all the conditions laid down in Article 400(2)(d) and Article 400(3) of Regulation (EU) No 575/2013 for an exemption to be granted;
 - (b) a legal opinion, issued either by an external independent third party or by an internal legal department, and approved by the management body, demonstrating that there are no obstacles that would hinder the timely repayment of exposures by a regional or central body to the credit institution arising from either applicable regulations, including fiscal regulations, or binding agreements;
 - (c) a statement signed by the legal representative and approved by the management body that:
 - (i) there are no practical impediments to the timely repayment of exposures by a regional or central body to the credit institution;
 - (ii) the regional or central body exposures are justified by the funding structure of the network;
 - (iii) the process by which a decision is made to approve an exposure to a regional or central body and the monitoring and review process applicable to such exposures, at legal entity level and at consolidated level, are similar to those applied to third-party lending;
 - (iv) the concentration risk arising from exposures to the regional or central body has been considered as part of the credit institution's overall risk assessment framework;
 - (d) documentation signed by the legal representative and approved by the management body attesting that the credit institution's risk evaluation, measurement and control procedures are the same as the regional or central body's and that the credit institution's risk management procedures, IT system and internal reporting enable the management body to continuously monitor the level of the large exposure and its compatibility with the credit institution's risk strategy at legal entity level and at consolidated level, where relevant, and with the principles of sound internal liquidity management within the network;
 - (e) documentation showing that the ICAAP clearly identifies the concentration risk arising from the large exposures to the regional or central body and that this is actively managed;
 - (f) documentation showing that the management of concentration risk is consistent with the network's recovery plan.
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