

CRD implementation in other jurisdictions – an update

July 2006

1. Our paper to the Basel 2/CRD Implementation Advisory Group in September 2005 summarised our view on the state of play then on CRD and Basel 2 implementation in a number of representative jurisdictions.¹ This paper provides an update for the EU jurisdictions and focuses on progress with CRD implementation, including approach to copy-out and transposition of CEBS material, and on remaining open issues.
2. This paper is based on soundings we took in May and June 2006 from regulatory colleagues at the Commission bancaire, the Nederlandsche Bank (DNB), the BaFin and the Banca de España, and on draft legislation and implementation documents, where available.

Progress with CRD implementation

3. Our indications at this stage are that all EU Member States will have adopted their implementing legislation for the CRD by 31 December 2006, although not all draft legislation is in the public domain at this stage. Most domestic legislation will probably be published between September and December 2006. Part of the reason for this is that some Member States are waiting for publication of the CRD in the Official Journal before taking the next formal step in their implementation process. As the European Parliament formally signed the CRD on 14 June 2006, we expect the official publication no later than end-July.
4. The following draft implementing legislation is now publicly available:
 - Germany: the secondary legislation on capital adequacy (*Solvabilitäts-Verordnung*, SolvV, draft of 31 March 2006)² and on large exposures (*Grosskredit- und Millionenkreditverordnung*, GroMiKV, draft of 16 March 2006) together cover the vast majority of the CRD. Both drafts are being publicly consulted on until 14 July, followed by public hearings in September. In addition, the BaFin's minimum requirements for risk management (MaRisk) implement the qualitative elements of Pillar 2.³

1 <http://www.fsa.gov.uk/pubs/international/basel29sept.pdf>.

2 <http://www.bundesbank.de/download/bankenaufsicht/pdf/entwurf.pdf>. This also includes a detailed concordance table: http://www.bundesbank.de/bankenaufsicht/bankenaufsicht_basel_nationaleumsetzung.php

3 Mindestanforderungen für das Risikomanagement, http://www.bafin.de/rundschreiben/89_2005/051220.htm.

- The Netherlands: The DNB's regulations focus on the CRD's technical Annexes. Almost all of these regulations are now available in draft.⁴
5. Further consultations have become available over the last few months, for example, the Banca d'Italia's consultations on operational risk and the standardised approach to credit risk of March 2006.⁵ The Austrian draft legislation of March 2006 is also available.⁶
 6. CEBS' supervisory disclosure project will eventually lead to all EEA regulators publishing details of how they implement the CRD. This will greatly increase transparency and be an excellent tool for firms and other interested parties to compare implementation in different jurisdictions in detail.

Style of transposition

Copy-out approach

7. From the soundings taken and reviews of the draft legislation available, all selected jurisdictions seem to be adopting a copy-out approach to a greater or lesser extent, that is, keeping their text fairly closely to the Directive text with few elaborations. However, it is important to recognise that adopting a 'copy-out' approach does not mean copying and pasting entire 'titles' of the CRD into domestic rules. Rather, it means fitting the wording of CRD provisions into the structure of the domestic legislation in each jurisdiction.
8. One obvious example of this is that topics in the CRD are often located both in the articles of the CRD and in the technical Annexes. In domestic implementation, these sections may then be pulled together in one coherent part (such as BIPRU 3 and chapter 3 of the SolvV covering the standardised approach to credit risk). In addition, in some jurisdictions the CRD may be implemented at different legislative levels. So parts of the CRD could be contained in legislation, but other parts in rules issued by the supervisory authority.
9. Even when transposing an individual section of the CRD, national authorities may choose a different (and often arguably more logical) order of provisions. For example, DNB's draft regulation on operational risk⁷ sets out the qualifying criteria for the use of the standardised approach at the beginning of the section (rather than, as in Annex X of the CRD, at the end of the section on the standardised approach).⁸ In summary, copy-out will look quite different between different Member States.
10. Some European regulators are also providing background and interpretative materials in addition to their implementing legislation.

⁴ <http://www.dnb.nl/dnb/pagina.jsp?pid=tcm:13-51359-64>, all available in English.

⁵ http://www.bancaditalia.it/vigilanza_tutela/vig_ban;internal&action=_framecontent.action&Target=_self – follow links to documenti Basilea 2 (Italian only).

⁶ http://www.fma.gv.at/basel2_de/baselii.htm, follow link to FMA/BMF: Entwürfe zur nationalen Basel II Umsetzung, 10.03.06 (German only).

⁷ See the DNB's consultation of November 2005 'Draft Supervisory Regulation on Operational Risk', http://www.dnb.nl/dnb/bin/doc/Concept-Regulation%20Operational%20Risk%20BIA%20and%20TSA%20%20OP01B%20EN_tcm13-67694.pdf.

⁸ This corresponds to the FSA's draft Handbook text, where eligibility criteria are at the beginning of the section on the standardised approach (BIPRU 6.4.1).

11. For example, Explanatory Notes form part of the DNB's draft regulations, including on the internal ratings-based approach, standardised approach to credit risk, credit risk mitigation and operational risk. These Explanatory Notes provide both general background and commentary on individual sections. In the case of the draft regulation on the internal ratings-based approach, they run to some 50 pages.⁹
12. Similarly, the German draft legislation is accompanied by non-binding explanatory notes (*Begründung*).¹⁰ These provide a guide to the legislation, its purpose and structure, and more detail on individual provisions. In addition, the BaFin and its industry groups drafted non-binding recommendations (*Empfehlungen*) in a number of areas, for example 13 recommendations for firms on the standardised approach to operational risk.¹¹

Use of CEBS materials

13. It is becoming clear that the EU regulators we contacted do not intend to transpose all CEBS guidance line-by-line in the same way as they are transposing the CRD. Instead, they seem to be adopting one or more of the following approaches to an *operational implementation* of CEBS material: (i) integrating certain parts of CEBS material into domestic rules, (ii) ensuring that domestic rules are consistent with or drafted in the light of CEBS guidelines, (iii) including CEBS material or references to it in non-binding explanatory materials to the rules, or (iv) following CEBS guidelines in the practical supervision of firms. Regardless of which approach or approaches Member States adopt, we do not expect this to produce differences in practice.
14. We have stated in CP06/3 that we consider that CEBS guidelines by their nature do not lend themselves to line-by-line copy-out within a principles-based approach, but that our implementation is consistent with CEBS guidelines.¹² And we will use the forthcoming Feedback Statement on CP06/3 to clarify our statements on CEBS guidelines further, in view of industry responses to our consultation. But decisions on CEBS references in the Handbook text will need to be taken on a case-by-case basis. For example, we consider that our Handbook reference to CEBS' guidelines on the recognition of ECAs (BIPRU 3.3.4 and 3.3.10) is appropriate as it merely informs CRD-scope firms about our approach to recognising rating agencies, rather than laying down obligations for CRD-scope firms.

Open issues

15. On both stress testing and estimating downturn LGDs, discussions continue internationally and with industry groups.
16. CEBS published a consultation paper on stress testing on 9 June 2006 (CP12).¹³ CP12 is consistent with our position which does not see stress testing as resulting automatically in the need for additional capital. Our aim is to ensure that firms consider all material risks they face and understand their possible impact.

9 http://www.dnb.nl/dnb/bin/doc/Concept-Regulation%20Credit%20Risk%20IRB%20_K01C%20EN__tcm13-67692.pdf.

10 <http://www.bundesbank.de/download/bankenaufsicht/pdf/begruendung.pdf>, only available in German.

11 <http://www.bafin.de/cgi-bin/bafin.pl?verz=0608010600&sprache=0&filter=&ntick=0>, only available in German.

12 CP06/3, paragraph 1.43.

13 <http://www.c-ebs.org/pdfs/CP12.pdf>

17. Specifically, the ‘exceptional but plausible’ scenario in CP12 is consistent with our proposed Pillar 1 IRB ‘one-in-25-year’ downturn scenario. In our view, this also corresponds to the ‘range of plausible but severe scenarios’ in the US draft interagency notice of proposed rulemaking.¹⁴ We are aware of industry concerns about our ‘one-in-25-year’ downturn scenario and are discussing this with the procyclicality expert group, recognising that thinking on stress testing is still developing internationally, as evidenced by ongoing discussions within the AIG.
18. More broadly, we are conducting thematic work with firms on stress testing to identify good risk management practices at firms. We intend to report back on this in September 2006.
19. The AIG continues work on estimating downturn LGDs in its validation sub-group. But it does not envisage developing new guidance to replace its earlier guidance endorsed by the Basel Committee in June 2005.¹⁵ We are continuing our work with the LGD expert group and undertaking a hypothetical portfolio project with firms to better understand good practice in the market.

¹⁴ <http://www.federalreserve.gov/generalinfo/basel2/DraftNPR/>, see p. 145.

¹⁵ <http://www.bis.org/publ/bcbs115.htm>.