

# COMMISSION OF THE EUROPEAN COMMUNITIES

COM(88) 194 final - SYN 133

Brussels, 20 April 1988

Proposal for a  
COUNCIL DIRECTIVE  
on a solvency ratio for credit institutions

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(presented by the Commission)

# COMMISSION OF THE EUROPEAN COMMUNITIES

CORRIGENDUM

COM(88) 194 final - SYN 133/2

Brussels, 28 April 1988

Proposal for a  
COUNCIL DIRECTIVE  
on a solvency ratio for credit institutions

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(presented by the Commission)

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EFFECT OF THE PROPOSAL OF DIRECTIVE ON SMALL AND  
MEDIUM SIZED ENTERPRISES AND THE LEVEL OF EMPLOYMENT

1. New administrative requirements for the enterprises arising from the application of the legislation:

None

2. Advantages for the enterprises:

The directive is one of the pre-requisite pieces of harmonisation involved in the establishment of a truly unified internal market in banking. The achievement of such a market should bring about a process of intensified competition and enhanced innovation which will increase customer choice and reduce the cost of banking services. The small and medium sized enterprises will accordingly benefit from wider choice, more favourable terms and financial products better suited to their needs. At the same time, the harmonisation proposed will strengthen the financial base of credit institutions and promote the stability of the banking system. This will have beneficial effects for overall economic performance.

3. Disadvantages for the enterprise (additional costs):

As a proposal aims to raise average solvency standards in order to protect the financial soundness of individual credit institutions and the overall stability of the European banking system, there may, in the short-term, be some increase in the cost of certain banking services in some Member States. Any such increases should in the longer-term be more than offset by the effects of greater competition between providers of banking services.

4. Effects on the level of employment:

The envisaged reduction in the cost of financial services, and the improvement in the quality of those services, should have favourable implications for the profitability of enterprises in other sectors, and thus on employment therein.

5. Has there be a prior consultation with social partners?

Yes, with banking associations.

What is their opinion:

Broadly favourable: they support the establishment of common prudential standards and the broad similarity of the proposal to standards being developed in a wider international framework. They are not all in favour of all features of the proposal, and believe that the supervisory authorities should not have the intended discretion to require solvency standards above the minimum proposed. The supervisors, on the other hand, unanimously support such flexibility.

6. Might there be a less stringent alternative approach?

No. The proposed directive aims to establish a comprehensive system of measuring solvency requirements. The minimum level of solvency set is necessary to ensure adequate prudential standards, as is allowance for a certain discretion for supervisory authorities to set stricter standards as they judge appropriate.

PROPOSAL FOR A COUNCIL DIRECTIVE ON A SOLVENCY  
RATIO FOR CREDIT INSTITUTIONS

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EXPLANATORY MEMORANDUM

I. PRELIMINARY REMARKS

Main objectives of the proposal

1. The proposal has two main objectives. The first is to achieve an important part of the harmonisation of prudential supervision necessary for completion of the internal market in banking. The second is to strengthen average solvency standards among Community credit institutions in order further to protect both depositors and investors and the stability of the banking system.
2. As part of the necessary harmonisation to be achieved before completion of the internal market, the proposed directive accompanies the proposal for a Directive on the definition of own funds of credit institutions (1) and the Commission Recommendations on large exposures and deposit guarantee schemes (2). It is particularly closely associated with the first mentioned proposal as own funds form the numerator of the proposed solvency ratio.

The principles of the ratio

3. The proposed ratio expresses the own funds of each credit institution as a proportion of the risk-adjusted value of its assets and off-balance sheet business. This type of "risk-weighting" approach was developed over the course of several years in work carried out for the Banking Advisory Committee established by the First Banking Coordination Directive of

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(1) OJ No C 243, 27.9.86, p. 4

(2) OJ No L 33, 4.2.87, pp. 10 and 16

1977 (1). It is now widely recognised as the most appropriate and flexible measure of solvency as it distinguishes between the degrees of risk associated with particular assets and off-balance sheet items. Simpler ratios making no distinction between types of assets and off-balance sheet engagements and the associated risks embody the implicit assumption that capital requirements should be the same for all kinds of transactions.

4. The ratio makes full allowance for the risks inherent in off-balance sheet business, an area of banks' activities which has grown rapidly in the recent past. From a prudential perspective it is essential to allow for the potential risk of items which may move on to banks' balance sheets, especially as this is likely to happen at a time when the average quality of their traditional loan books is deteriorating.
5. The ratio principally relates to the credit risks involved in the event of counterparty default. However, the recitals make reference to further work on the prudential treatment of interest rate and exchange rate risk, and other market risks. In particular, the Commission has begun the necessary work required in order to propose in due course the necessary provisions to establish a framework for the control of market risks arising out of open positions taken on by credit institutions in respect of their operations on securities markets.

A minimum standard

6. The proposal establishes common definitions and techniques for a solvency ratio. Beyond this it establishes a minimum level for that ratio, to be respected by all Community credit institutions from 1 January 1993 onwards. The proposal contains a provisional minimum figure of 8% selected after consideration of the confidential statistics collected since 1981 for the Advisory Committee. The Commission considers it necessary to include this indicative figure so that the effect of the proposal can be judged as a whole. It is intended that the figure should be reviewed following a statistical survey of credit institutions' ratios based on the definitions in the proposal. This survey has been prepared by the Commission and

will be conducted in the first half of 1988 by the Contact Group of EC banking supervisors. The Commission will, if necessary, in the light of the results of that survey, propose an amendment to the figure before the Directive is finally adopted.

7. To ensure the continuous strengthening of capital standards, the proposal stipulates that between the coming into force of the directive on 1 January 1990 and the date from which the minimum ratio must be respected, 1 January 1993, no credit institution with a ratio below that minimum may allow it to fall except temporarily in the period immediately after the issuing new capital.

Equality of treatment for Community borrowers; treatment of country risk

8. For the purposes of assigning risk weights to various assets and off-balance sheet items, borrowers are grouped in a number of broad categories: central banks, central governments, credit institutions, and so on. Beyond this distinction drawn on the basis of the type of borrower, there is a distinction between "domestic", meaning EC, borrowers and "foreign", meaning all other borrowers. In the case of most inter-bank business, reflecting the homogeneity of the short-term inter-bank market, loans to "domestic" and "foreign" banks are given the same weight. This is also true of loans to, and off-balance sheet items incurred on behalf of, "domestic" and "foreign" non-banks. But in the case of other types of borrower, central banks and central governments and so on, and in the case of long-term inter-bank business, "domestic" borrowers receive lower weights than their "foreign" counterparts. The distinction goes much of the way towards making allowance for the element of country risk in banks' lending, but it is nonetheless true that the residual "foreign" category contains a mixture of (a smaller number of) highly

creditworthy countries and (a larger number of) those with external financing problems. For this reason, and in the case of inter-bank business for the additional reason that several non-EC G-10 members seem likely in the near future to reinforce the solvency of their banks by the adoption of standards similar to those contained in this proposal, Article 8 allows for the possibility of extending "domestic" weights to "foreign" borrowers, where the risks are considered equivalent.

#### Adaptation of the ratio: Committee procedure

9. It is important that, once the Directive is in force, it should be possible to adapt the ratio as quickly as possible to changes in banks' business and in the nature of risks run. This is particularly true of the new off-balance sheet transactions which are captured by the ratio. Accordingly, a flexible adaptation procedure is proposed. The use of Regulatory Committee version (a) is preferred in view of the sensitivity of the banking sector and the central role of national banking supervisory authorities in the operation of the proposed Directive.

## II. COMMENT ON THE ARTICLES

### Scope (Articles 1 and 3(2))

1. Article 1 stipulates that the proposal applies to all credit institutions as defined in the first indent of Article 1 of the First Coordination Directive allowing for certain exemptions made in that Directive and in 86/524 (1). This definition explicitly excludes branches of third country banks located in Member States from the scope of the proposal. The question of who is responsible for the supervision of the

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(1) OJ No L 309, 4.11.86, p. 15



solvency of these branches will continue to be decided by the competent authorities of the host Member States. Prevailing standard practice is for supervision to be carried out by relevant third country authorities where supervisory standards are recognised as equivalent.

2. Article 3(2) offers further precision concerning the institutional basis on which the ratios are to be calculated and respected. The first requirement is that consolidated ratios, in conformity with Directives 83/350 (1) and 86/635(2) must be calculated and respected. In addition, unconsolidated ratios for all credit institutions are prescribed. Discretion is offered to national supervisory authorities to require sub-consolidated rather than unconsolidated ratios for subsidiary credit institutions.

#### Definitions (Article 2)

3. A routine list of definitions, partly drawn from earlier Directives in the banking field, is proposed in order to simplify and standardise the text.

#### General principles (Article 3)

4. This article establishes a number of basic principles relating to the proposal:
  - Article 3(1) provides a simple description of the proposed solvency ratio. This is subsequently elaborated in Articles 4-6 and the Annexes, but Article 3(1) offers the only complete description of method;
  - Article 3(2) is discussed at II(2) above;

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(1) OJ No L 193, 13.6.83, p. 18

(2) OJ No L 372, 8.12.86, p. 1

- Article 3(3) stipulates that there shall be formal verification and control of the ratios at least twice a year;
- Article 3(4) establishes that the balance and off-balance sheet items referred to in the proposal shall be valued according to the harmonised standards of the Annual Accounts Directive.

The numerator of the ratio (Article 4)

5. The proposed numerator is own funds as they are finally defined in the directive on the definition of own funds.

The denominator of the ratio (Articles 5 and 6 and Annexes 1-4)

6. Article 5 provides a description of the method used to arrive at risk-adjusted values for balance and off-balance sheet items. Fuller descriptions of method and lists of instruments are given in annex form in the case of off-balance sheet items, whose treatment in the ratio is more complex than that of balance sheet items.
7. Article 6 lists the asset and off-balance sheet items falling under each risk weight (0%, 10%, 20%, 50% and 100%). The proposed treatment of interest and exchange rate related off-balance sheet items cannot be presented in this manner and is instead covered in Annex 3.
8. Article 7 explains the risks applicable in the case of claims on, and off-balance sheet business undertaken on behalf of, local authorities and regional governments. The proposed system is one of mutual recognition of the weights deemed appropriate to their own local authorities by individual supervisory authorities.

Implementation powers of the Commission; modification procedures  
(Article 8)

9. In view of the pace of change and innovation in the banking sector it is proposed that most of the technical features of the directive should be subject to modification, as appropriate, on the initiative of the Commission, after consultation with the Banking Advisory Committee. It is proposed that the latter should act in the capacity of a regulatory committee. The extension of "domestic" weights to third countries, referred to in section I paragraph 8, is one of the specific features which it is proposed may be undertaken in accordance with the modification procedures of the Article.

Implementation of the directive (Article 9)

10. Following the timetable of the Second Banking Coordination Directive, it is proposed that the appropriate compliance measures should be adopted by 1 January 1990.
11. Article 9 stipulates that a minimum solvency ratio must be continuously respected by credit institutions after 1 January 1993. It provides that, in the event of ratios falling below the minimum, competent authorities must ensure that corrective action is taken.
12. It also states that those credit institutions whose solvency ratios are below the stipulated minimum at the time of the coming into force of the directive must not, except in the particular case of an issue of capital, allow their ratios to fall between that date and the end of 1992. The intention as explained earlier is to promote the continuous strengthening of capital standards before the minimum level established in the proposal becomes binding with effect from 1 January 1993.

13. The article additionally makes it clear that the figure in paragraph 3 is a minimum and that national supervisory authorities may require higher ratios according to their judgment.

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PROPOSAL FOR A COUNCIL DIRECTIVE ON A  
SOLVENCY RATIO FOR CREDIT INSTITUTIONS

THE COUNCIL OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community, and in particular Article 57(2), third sentence thereof,

Having regard to the proposal from the Commission,

In cooperation with the European Parliament,

Having regard to the opinion of the Economic and Social Committee,

Whereas the Directive is a development from the work undertaken by the Banking Advisory Committee which has, under Article 6(4) of Council Directive 77/780/EEC of 12 December 1977 on the co-ordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions (1), as amended by Directive 86/524/EEC (2), responsibility for making "suggestions to the Commission with a view to coordinating the coefficients applicable in the Member States";

Whereas appropriate solvency ratios play a central role in the prudential supervision of credit institutions;

Whereas ratios which weight assets and off-balance sheet transactions according to the degree of credit risk are particularly useful measures of solvency;

Whereas the development of common standards of capital adequacy in relation to assets and off-balance sheet items at risk is accordingly, one of the essential areas of harmonization necessary for the achievement of mutual recognition and thus the completion of the internal market in banking services;

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(1) OJ No L 322, 17.12.1977, p. 30

(2) OJ No L 309, 4.11.1986, p. 15.

Whereas in this respect the Directive is connected with other specific legislation also harmonizing the fundamental techniques of prudential supervision : Council Directive / /EEC on own funds (1), the Commission Recommendations 87/62/EEC (2) and 87/63/EEC (3) on large exposures and deposit protection schemes;

Whereas the Directive should also be seen as directly complementary to the Second Coordination Directive which lays out the broader framework of which this Directive is an integral part;

Whereas the minimum ratio contained in this Directive is provisional in nature; whereas it will be reviewed following a statistical survey; whereas the Commission will, if necessary, duly propose an amendment to the figure before the final adoption of the Directive;

Whereas measurement of, and allowance for, interest and exchange rate risk, and other market risks, are also of great importance in prudential supervision; whereas, the Commission shall, accordingly, in cooperation with the competent authorities of Member States and others working toward similar ends, further study the available techniques; whereas it shall then make appropriate proposals for the further harmonisation of prudential rules relating to these risks;

Whereas technical modification to the detailed rules contained in this Directive may from time to time be necessary to respond to new developments in the banking sector; whereas the Commission shall accordingly make such modifications as are necessary, after consulting the Banking Advisory Committee, within the limits of the implementing powers delegated to the Commission by the provisions of the Treaty; whereas that Committee shall act as a "Regulatory" Committee, according to the rules of procedure laid down in Article 2, procedure III variant a) of Council Decision 87/373/EEC of 13 July 1987 laying down procedures for the exercise of implementing powers conferred to the Commission(4).

HAS ADOPTED THIS DIRECTIVE:

- (1) OJ No L
- (2) OJ No L 33, 4.2.87, p. 10
- (3) OJ No L 33, 4.2.1987, p. 16
- (4) OJ No L 197, 18.7.1987, p. 33

Scope and definitions

Article 1

1. This Directive shall apply to credit institutions within the meaning of the first indent of Article 1 of Directive 77/780/EEC.
2. Notwithstanding indent 1 above, the Member States need not apply this Directive to credit institutions listed in Article 2(2) of Directive 77/780/EEC.
3. Credit institutions which, as defined in Article 2(4)(a) of Directive 77/780/EEC are affiliated to a central body in the same Member State, may be exempted from the provisions of this Directive, provided that the totality of those affiliated credit institutions and the central body are included in consolidated solvency ratios in accordance with this Directive.

Article 2

For the purposes of this Directive :

- "competent authorities" shall be defined in accordance with the fifth indent of Article 1 of Council Directive 83/350/EEC of 13 June 1983 on the supervision of credit institutions on a consolidated basis (1);
- "domestic credit institutions" shall comprise all credit institutions authorized in the Member States, in accordance with Article 3 of Directive 77/780/EEC, and branches of those institutions established outside the EC;
- "foreign credit institutions" in this Directive shall comprise all private and public undertakings licensed outside the Member States which satisfy the definition in the first indent of Article 1 of Directive 77/780/EEC, and their branches;
- in the case of central governments and central banks, regional governments and local authorities, and the non-bank sector as defined below, "domestic" shall mean of the Member States; "foreign" shall mean of other countries;
- "non-bank sector" shall be defined as all borrowers other than credit institutions as defined in the second and third indents above, central governments and central banks, regional governments and local authorities, the European Communities and the European Investment Bank (EIB), and the Bank for International Settlements (BIS), the International Bank for Reconstruction and Development (IBRD), and the International Monetary Fund (IMF);

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(1) OJ No L 193, 18.7.83, p. 18



- "full risk", "medium risk", "medium/low risk" and "low risk" off-balance sheet items are described in Annex 1 and listed in Annex 2;
- "participation" shall be defined in accordance with the third indent of Article 1 of Directive 83/350/EEC.

Article 3General principles

1. For the purposes of measuring the solvency of credit institutions as defined in Article 1, the competent authorities of Member States shall ensure that ratios are calculated for each credit institution which express its own funds, as defined in Article 4, as a proportion of its total risk adjusted assets and off-balance sheet items, as defined in Article 5.
2. Ratios shall be calculated on a consolidated basis in accordance with Directive 83/350/EEC and Council Directive 86/635/EEC of 8 December 1986 on the annual accounts and consolidated accounts of banks and other financial institutions (1). Notwithstanding the above requirement, unconsolidated ratios shall also be calculated for all credit institutions. However, the competent authorities shall have the discretion to require subconsolidated rather than unconsolidated ratios for credit institution subsidiaries.
3. Without prejudice to the compliance obligations of credit institutions established in Articles 9(2), (3) and (4), the competent authorities shall ensure that the ratios are controlled not less than twice each year.
4. Valuation of assets and off-balance sheet items shall be undertaken in accordance with Directive 86/635/EEC.

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(1) OJ No L 372, 31.12.86, p. 1

Article 4

Own funds: the numerator

Own funds, as defined in Directive .../.../EEC of .../.../19.. on the own funds of credit institutions<sup>T</sup>, shall form the numerator of the solvency ratio.

Article 5Risk-adjusted assets and off-balance sheet transactions: the denominator

1. Degrees of credit risk, expressed as percentage weights, shall be assigned to the asset items in accordance with the provisions of Article 6. The balance sheet value of each asset shall then be multiplied by the relevant weight to arrive at a risk-adjusted value.
2. In the case of the off-balance sheet items included in categories (a) to (e) of Article 6, a two-stage calculation, in accordance with rules presented in Annex 1, shall be used to arrive at risk weights. Risk-adjusted values shall be obtained by multiplying the value of each off-balance sheet item by the relevant risk weight.
3. In the case of the interest rate and foreign exchange rate related off-balance sheet items in Article 6(2), the potential costs of replacing cash flows in the event of counterparty default shall be assessed by the application of either of the two methods presented in Annex 3. These costs shall be multiplied by the relevant counterparty weights in Article 6(1) to give risk-adjusted values.
4. The total of the risk-adjusted values of assets and off-balance sheet items described above shall be the denominator of the solvency ratio.

Article 6

Risk weights

1. The following weights shall be applied to the asset and off-balance sheet items shown below, although the competent authorities may establish higher weights as they see fit :

(a) Nil weight

- cash in hand and equivalent items;
- asset items representing claims on "domestic" central governments and central banks;
- asset items representing claims carrying the explicit guarantee of "domestic" central governments and central banks;
- asset items representing claims on the European Communities and the EIB;
- asset items carrying the explicit guarantee of the European Communities and the EIB;
- asset items representing claims on the BIS, IBRD and IMF;
- asset items carrying the explicit guarantee of the BIS, IBRD and IMF;
- all off-balance sheet items incurred on behalf of "domestic" central governments and central banks;
- all off-balance sheet items carrying the explicit guarantee of "domestic" central governments and central banks;
- all off-balance sheet items incurred on behalf of the European Communities and the EIB;
- all off-balance sheet items carrying the explicit guarantee of the European Communities and the EIB;
- all off-balance sheet items incurred on behalf of the BIS, IBRD and IMF;
- all off-balance sheet items carrying the explicit guarantee of the BIS, IBRD and IMF;

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- loans and off-balance sheet items, fully and completely secured to the satisfaction of the relevant competent authorities, by any of the asset items shown above and by deposits and certificates of deposit with the lending institutions;
- all off-balance sheet items having low risk, regardless of counterparty.

(b) 10% weight

- off-balance sheet items, having medium risk, incurred on behalf of "domestic" credit institutions;
- off-balance sheet items, having medium risk carrying the explicit guarantee of "domestic" credit institutions;
- off-balance sheet items, having medium risk and an original maturity of up to and including one year, incurred on behalf of "foreign credit institutions";
- off-balance sheet items, having medium risk and an original maturity of up to and including one year, carrying the explicit guarantee of "foreign" credit institutions.

(c) 20% weight

- asset items representing claims on "domestic" credit institutions;
- asset items representing claims, with an original maturity of up to and including one year, on "foreign" credit institutions;
- asset items carrying the explicit guarantee of "domestic" credit institutions;
- asset items representing claims, with an original maturity of up to and including one year, carrying the explicit guarantee of "foreign" credit institutions;
- off-balance sheet items, having full risk, incurred on behalf of "domestic" credit institutions;
- off-balance sheet items, having full risk, carrying the explicit guarantee of "domestic" credit institutions;

- off-balance sheet items, having full risk and an original maturity of up to and including one year, incurred on behalf of "foreign" credit institutions;
- off-balance sheet items, having full risk and an original maturity of up to and including one year, carrying the explicit guarantee of "foreign" credit institutions;
- loans and full and medium risk off-balance sheet items, fully and completely secured to the satisfaction of the relevant competent authorities, by any of the asset items shown above in the 20 % weight category;
- off-balance sheet items having medium/low risk incurred on behalf of the "domestic" and "foreign" non-bank sectors;
- asset items representing local currency claims of "foreign" branches of domestic credit institutions on "foreign" central governments, funded by local currency deposits;
- cash items in process of collection, where the corresponding prior payments have already been made.

(d) 50% weight

- off-balance sheet items, having medium risk, incurred on behalf of "foreign" central and regional governments, local authorities and central banks and the "domestic" and "foreign" non-bank sectors;
- off-balance sheet items, having medium risk and an original maturity of more than one year, incurred on behalf of "foreign" credit institutions;
- off-balance sheet items, having medium risk and an original maturity of more than one year, carrying the explicit guarantee of "foreign" credit institutions;
- loans to individuals for the purchase of residential property in the Community for their own occupation, fully and completely secured to the satisfaction of the relevant competent authorities, by mortgages on the property in question.

(e) 100% weight

- asset items representing claims on "foreign" central and regional governments, local authorities and central banks;
  - asset items representing claims, with an original maturity of more than one year, on "foreign" credit institutions;
  - asset items representing claims on the "domestic" and "foreign" non-bank sectors;
  - off-balance sheet items, having full risk, incurred on behalf of "foreign" central and regional governments, local authorities and central banks and the "domestic" and "foreign" non-bank sectors;
  - off-balance sheet items, having full risk and an original maturity of more than one year, incurred on behalf of "foreign" credit institutions;
  - tangible assets in accordance with assets heading C.II of Article 9 of Council Directive 78/660/EEC of 25 July 1978 on the annual accounts of certain types of companies (1);
  - participations where not deducted from own funds;
  - all other assets except where deducted from own funds.
2. The methods laid out in Annex 3 shall be applied to interest rate and foreign exchange rate related off-balance sheet instruments.

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(1) OJ No L 222, 14.8.1978, p. 11



Article 7

1. Member States shall fix weights of either 0%, 20% or 50% in the case of asset items representing claims on their own regional governments and local authorities, and full risk off-balance sheet items incurred on behalf of their own regional governments and local authorities. Medium risk off-balance sheet items incurred on behalf of their own regional governments and local authorities shall correspondingly be weighted at 0%, 10% or 20%. Loans and off-balance sheet items carrying the explicit guarantee of a regional or local authority shall have the same weight as loans to, or off-balance sheet items incurred on behalf of, the same regional government or local authority.
  
2. Member States shall notify the Commission of their weights, the Commission shall disseminate that information and Member States shall mutually respect the weights chosen by each other. They shall have the discretion to apply weights of either 0%, 20% or 50% in the case of those foreign countries determined in accordance with Article 8(2), with medium risk off-balance sheet items.  
weighted correspondingly at 0%, 10% or 20%.

Article 8

1. Technical modifications in the areas of this Directive shown below may be made in accordance with the procedure set out in paragraph 3:
  - the minimum ratio established in Article 9;
  - the weights and asset items in Article 6;
  - the list and classification of off-balance sheet items in Annexes 2 and 4 and their treatment in the calculation of the ratio as described in Article 5 and Annexes 1 and 3.
2. The Commission may also, according to the procedure set out in paragraph 3, extend to foreign countries the same weights applied to domestic central governments, central banks and credit institutions, where the risks are considered equivalent, notably in the case of credit institutions, because of arrangements made in an international context and similarly to extend the 50% weight for mortgage-backed loans for the purchase of property in foreign countries.
3. The Commission shall be assisted by a Committee composed of representatives from the Member States and chaired by a representative of the Commission.

The representative of the Commission shall submit to the Committee a plan of measures to take. The Committee shall give its opinion on the plan within a time limit to be fixed by the Chairman in accordance with the urgency of the matter. The opinion shall be given on a qualified majority basis according to Article 148(2) of the Treaty in the case of decisions which the Council is called upon to take following a proposal of the Commission. In the Committee the votes of the representatives shall be weighted according to the above-mentioned article. The Chairman shall not vote.

The Commission shall implement the envisaged measures when they are in conformity with the opinion of the Committee.

When the envisaged measures do not conform with the opinion of the Committee, or in the absence of an opinion, the Commission shall without delay submit to the Council a proposal relating to the measures to take. The Council shall act according to qualified majority voting.

If at the end of the period which will be set in the case of each decision to be taken by the Council as a result of this paragraph, a period which must not exceed three months from the day on which the Council was informed, the Council has not acted, the Commission shall implement the proposed measures.

Article 9

1. Member States shall adopt the measures necessary to comply with the provisions of this Directive by 1 January 1990.
  
2. Until 31 December 1992, credit institutions whose ratios are below 8%\* shall not allow their ratios to fall unless such falls are associated with the issue of new capital and occur in the period immediately following such issuance. The competent authorities shall ensure that corrective measures are taken if falls occur for any reason other than that referred to above.
  
3. With effect from 1 January 1993, credit institutions shall not allow their ratios, as defined in Articles 3(1) and 3(2), to fall below 8 %\*. In the event of such an occurrence, the competent authorities shall ensure that appropriate measures to restore the ratio to the agreed minimum are taken as quickly as possible by the credit institution in question.
  
4. Notwithstanding paragraph 3, the competent authorities may establish ratios above 8%\* as they consider appropriate.
  
5. Member States shall communicate to the Commission the texts of the main laws, regulations and administrative provisions which they adopt in the field covered by this Directive.

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\* This figure is provisional. A definitive figure will be proposed after study of the results of a statistical exercise to be undertaken in the first half of 1988.

Article 10

This Directive is addressed to the Member States.

Done at

For the Council

ANNEX 1 : The treatment of off-balance sheet items  
in the solvency ratio

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The items shall first be grouped according to the perceived credit risk attaching to the instrument in question (see Annex 2). "Full risk" off-balance sheet items shall be deemed to carry a credit risk equal to balance sheet items, and thus their full value taken into account; "medium risk" items shall be considered to carry less risk and only one-half of their value taken into account; medium/low risk items shall be deemed to carry lower risk than the medium category and one-fifth of their value taken into account; "low risk" items shall be considered to carry negligible risk and their value accordingly set at zero. The second stage shall be to multiply the off-balance sheet values, adjusted as described above, by the weights attributable to the relevant counterparties, in accordance with the treatment afforded to asset items. In the case of asset sale and repurchase agreements and outright forward purchases, the weights shall be those attaching to the assets in question and not to the counterparties to the transactions. Article 6 combines the two-stage process used for off-balance sheet items into a single percentage weight.

Where off-balance sheet items carry explicit guarantees, they shall be weighted as if they were incurred on behalf of the guarantor rather than the counterparty. Where potential exposure arising from off-balance sheet business is fully and completely secured, to the satisfaction of the relevant competent authorities, by any assets having a 0% or 20% weight, the weight applicable to the collateral and not to the counterparty shall be used.

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ANNEX 2: classification of off-balance sheet items

Full risk

- Guarantees having the character of credit substitutes;
- Acceptances;
- Endorsements on bills not carrying the name of other credit institutions;
- Transactions with recourse;
- Irrevocable standby letters of credit having the character of credit substitutes;
- Asset sale and repurchase agreements as defined in Articles 12(1) and (2) of Directive 86/635/EEC, if these agreements are treated as off-balance sheet items pending full compliance with Directive 86/635/EEC;
- Assets purchased under outright forward purchase agreements;
- The unpaid portion of partly-paid shares and securities;
- Other items also carrying full risk.

Medium risk

- Documentary credits issued and confirmed (see also medium/low risk);
- Warranties and indemnities (including tender, performance, customs and tax bonds) and guarantees not having the character of credit substitutes;
- Asset sale and repurchase agreements as defined in Articles 12(3) and (5) of Directive 86/635/EEC;
- Irrevocable standby letters of credit not having the character of credit substitutes;
- Undrawn credit facilities (agreements to lend purchase securities, provide guarantees, acceptance facilities) with an original maturity of more than one year;
- Other items also carrying medium risk.

Medium/low risk

- Documentary credits in which underlying shipment acts as collateral and other self-liquidating transactions.
- Other items also carrying medium/low risk.

Low risk

- Undrawn credit facilities (agreements to lend, purchase securities, provide guarantees, acceptance facilities) with an original maturity of up to and including one year.
- Other items also carrying low risk.



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ANNEX 3: The treatment of interest rate and foreign  
exchange rate related off-balance sheet items

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Subject to the consent of their supervisory authorities, credit institutions shall choose one of the methods presented below to measure the risks associated with the transactions listed in Annex 4. Interest and exchange rate contracts traded on recognised exchanges, and exchange rate contracts with an original maturity of 7 days or less shall be excluded.

Method 1: the "marking to market" approach

Step (a): on the basis of attaching current market values to contracts (marking to market) the current replacement cost of all contracts with a positive value shall be obtained.

Step (b): to obtain a figure for potential future credit exposure the notional principal amounts or values underlying the institutions' aggregate books shall be multiplied by the following percentages (1):

<u>residual maturity</u>	<u>interest rate contracts</u>	<u>exchange rate contracts</u>
less than one year	nil	1%
one year and over	0.5%	5%

Step (c): the sum of current replacement cost and potential future credit exposure shall be multiplied by the risk weight attached to the relevant counterparties in Article 6.

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(1) These percentages are provisional and subject to revision.

Method 2: the "original exposure" approach

Step (a): the notional principal amounts of each instrument shall be multiplied by the percentages given below (1):

<u>original maturity</u>	<u>interest rate contracts</u>	<u>exchange rate contracts</u>
less than one year	0.5%	2%
one year and less than 2 years	1%	6%
additional allowance for each subsequent year	1%	4%

Step (b): the original exposures thus obtained shall be multiplied by the counterparty weights given in Article 6.

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(1) These percentages are provisional and subject to revision.

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ANNEX 4: Types of interest and foreign exchange rate  
related off-balance sheet items

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Interest rate contracts

- Single-currency interest rate swaps
- Basis swaps
- Forward rate agreements
- Interest rate futures
- Interest rate options purchased
- Other contracts of similar nature

Exchange rate contracts

- Cross-currency interest rate swaps
- Forward foreign exchange contracts
- Currency futures
- Currency options purchased
- Other contracts of similar nature

EFFECT OF THE PROPOSAL OF DIRECTIVE ON SMALL AND  
MEDIUM SIZED ENTERPRISES AND THE LEVEL OF EMPLOYMENT

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1. New administrative requirements for the enterprises arising from the application of the legislation:

None

2. Advantages for the enterprises:

The directive is one of the pre-requisite pieces of harmonisation involved in the establishment of a truly unified internal market in banking. The achievement of such a market should bring about a process of intensified competition and enhanced innovation which will increase customer choice and reduce the cost of banking services. The small and medium sized enterprises will accordingly benefit from wider choice, more favourable terms and financial products better suited to their needs. At the same time, the harmonisation proposed will strengthen the financial base of credit institutions and promote the stability of the banking system. This will have beneficial effects for overall economic performance.

3. Disadvantages for the enterprise (additional costs):

As a proposal aims to raise average solvency standards in order to protect the financial soundness of individual credit institutions and the overall stability of the European banking system, there may, in the short-term, be some increase in the cost of certain banking services in some Member States. Any such increases should in the longer-term be offset by the effects of greater competition between providers of banking services.

4. Effects on the level of employment:

The envisaged reduction in the cost of financial services, and the improvement in the quality of those services, should have favourable implications for the profitability of enterprises in other sectors, and thus on employment therein.

5. Will there be prior consultations with social partners?

Yes

Opinion of social partners:

Favourable

6. Might there be a less stringent alternative approach?

No. The proposed directive aims to establish a comprehensive system of measuring solvency requirements. The minimum level of solvency set is necessary to ensure adequate prudential standards.