DIRECTIVE 98/33/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

of 22 June 1998

amending Article 12 of Council Directive 77/780/EEC on the taking up and pursuit of the business of credit institutions, Articles 2, 5, 6, 7, 8 of and Annexes II and III to Council Directive 89/647/EEC on a solvency ratio for credit institutions and Article 2 of and Annex II to Council Directive 93/6/EEC on the capital adequacy of investment firms and credit institutions

THE EUROPEAN PARLIAMENT AND THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular the first and third sentences of Article 57(2) thereof,

Having regard to the proposal from the Commission [1],

Having regard to the opinion of the Economic and Social Committee [2],

Acting in accordance with the procedure referred to in Article 189b of the Treaty [3],

(1) Whereas the first Council Directive (77/780/EEC) of 12 December 1977 on the coordination of the laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions [4] allows the exchange of information between competent authorities and certain other authorities or bodies within a Member State or between Member States; whereas the said Directive also allows the conclusion by Member States of cooperation agreements providing for the exchange of information with the competent authorities of third countries; whereas on grounds of consistency, this authorisation to conclude agreements on the exchange of information with third countries should be extended so as to include the exchange of information with certain other authorities or bodies in those countries provided that the information disclosed is subject to appropriate guarantees of professional secrecy;

(2) Whereas Council Directive 89/647/EEC of 18 December 1989 on a solvency ratio for credit institutions [5] weights assets and off-balance-sheet items according to their degree of credit risk;

(3) Whereas churches and religious communities which, constituted in the form of a legal person under public law, raise taxes in accordance with the laws conferring such a right on them represent a credit risk similar to that of regional governments and local authorities; whereas, accordingly, it is consistent to afford the competent authorities the possibility of treating claims on churches and religious communities in the same way as claims on regional governments and local authorities where these churches and religious communities raise taxes; whereas, however, the option to apply a 0 % weighting to claims on regional governments and local authorities shall not extend to claims on churches and religious communities only on the basis of the right to raise taxes;

(4) Whereas Commission Directive 94/7/EC of 15 March 1994 adapting Council Directive 89/647/EEC on a solvency ratio for credit institutions as regards the technical definition of 'multilateral development banks' [6] included the European Investment Fund in that definition; whereas the Fund constitutes a new and unique structure of cooperation in Europe in order to contribute to the strengthening of the internal market, the promotion of economic recovery in Europe and the furthering of economic and social cohesion;

(5) Whereas within the meaning of Article 6(1)(d)(7) of Directive 89/647/EEC, a weighting of 100 % should be applied to the unpaid portion of capital

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(1) OJ C 208, 19.7.1996, p. 8, and OJ C 259, 26.8.1997, p. 1.
(2) OJ C 30, 30.1.1997, p. 13.
(3) Opinion of the European Parliament of 10 April 1997 (OJ C 132, 28.4.1997, p. 234), Council common position of 9 March 1998 (OJ C 135, 30.4.1998, p. 32) and Decision of the European Parliament of 30 April 1998 (OJ C 152, 18.5.1998). Council Decision of 19 May 1998.
(4) OJ L 322, 17.12.1977, p. 30. Directive as last amended by Directive 96/13/EC (OJ L 66, 16.3.1996, p. 15).
(5) OJ L 386, 30.12.1989, p. 14. Directive as last amended by Directive 98/32/EC (see page 29 of this Official Journal).
(6) OJ L 89, 6.4.1994, p. 17.

subscribed to the European Investment Fund by credit institutions;

(6) Whereas the capital of the European Investment Fund reserved for subscription by financial institutions is limited to 30 %, of which 20 % is to be paid up at the outset in four annual payments each of 5 %; whereas, accordingly, 80 % is not to be paid up, remaining a contingent liability on the members of the Fund; whereas, having regard to the European Council's stated objective when creating the Fund of encouraging commercial banks to participate, such participation should not be penalised and whereas, accordingly, it would be more appropriate to apply a 20 % weighting to the unpaid portion of subscribed capital;

(7) Whereas Annex I to Directive 89/647/EEC, which deals with the classification of off-balance-sheet items, classifies certain items as full risk and, accordingly, applies a 100 % weighting; whereas Article 6(4) of that Directive lays down that 'where off-balance-sheet items carry explicit guarantees, they shall be weighted as if they had been incurred on behalf of the guarantor rather than the counterparty. Where the potential exposure arising from off-balance-sheet transactions is fully and completely secured, to the satisfaction of the competent authorities, by any of the asset items recognised as collateral in paragraph 1(a)(7) or 1(b)(11), weightings of 0 % or 20 % shall apply, depending on the collateral in question';

(8) Whereas the clearing of over-the-counter (OTC) derivative instruments provided by clearing houses acting as a central counterparty plays an important role in certain Member States; whereas it is appropriate to recognise the benefits from such a clearing in terms of a reduction of credit risk and related systemic risk in the prudential treatment of credit risk; whereas it is necessary for the current and potential future exposures arising from cleared OTC derivatives contracts to be fully collateralised and for the risk of a build-up of the clearing house's exposures beyond the market value of posted collateral to be eliminated in order for cleared OTC derivatives to be granted for a transitional period the same prudential treatment as exchange-traded derivatives; whereas the competent authorities must be satisfied as to the level of the initial margins and variation margins required and the quality of and the level of protection provided by the posted collateral;

(9) Whereas account should also be taken of the case where the guarantee is secured by real collateral within the meaning of Article 6(1)(c)(1) in respect of off-balance-sheet items which are sureties or guarantees having the character of credit substitutes;

(10) Whereas within the meaning of points 2, 4 and 7 of Article 6(1)(a) of Directive 89/647/EEC, a zero weighting is applied to assets constituting claims on Zone A central governments and central banks or explicitly guaranteed by them and to assets secured by collateral in the form of Zone A central government or central bank securities; whereas, within the meaning of Article 7(1) of that Directive, the Member States may, on certain conditions, apply a zero weighting to assets constituting claims on their own regional governments and local authorities and to claims on third parties and off-balance-sheet items held on behalf of third parties and guaranteed by those regional governments or local authorities;

(11) Whereas Article 8(1) of Directive 89/647/EEC lays down that the Member States may apply a weighting of 20 % to asset items which are secured, to the satisfaction of the competent authorities, by collateral in the form of securities issued by Zone A regional governments or local authorities; whereas collateral in the form of securities issued by regional governments or local authorities of the Member States should be regarded as being guaranteed by those regional governments and local authorities within the meaning of Article 7(1) with a view to allowing the competent authorities to apply a zero weighting to assets and off-balance-sheet items secured by such collateral, again subject to the conditions laid down in that paragraph;

(12) Whereas Annex II to Directive 89/647/EEC lays down the treatment of off-balance-sheet items commonly referred to as OTC-derivative instruments concerning interest and foreign exchange rates in the context of the calculation of credit institutions' capital requirements;

(13) Whereas Articles 2(1)(a), Article 2(2), Article 2(3)(b), and Article 2(6) and Article 3(1) and (2) of this Directive and the Annex thereto are in accordance with the work of an international forum of banking supervisors on a refined and in

some aspects more stringent supervisory treatment of the credit risks inherent in OTC derivative instruments, in particular the extension of compulsory capital cover to OTC derivative instruments concerning underlyings other than interest and foreign exchange rates and the possibility of taking into account the risk-reducing effects of contractual netting agreements recognised by competent authorities when calculating the capital requirements for the potential future credit risks inherent in OTC derivative instruments;

(14) Whereas for internationally active credit institutions and groups of credit institutions in a wide range of third countries, which compete with Community credit institutions, the rules adopted on the wider international level will result in a refined supervisory treatment of OTC derivative instruments; whereas this refinement results in a more appropriate compulsory capital cover taking into account the risk-reducing effects of supervisorily recognised contractual netting agreements on potential future credit risks;

(15) Whereas for Community credit institutions a similar refinement of the supervisory treatment of OTC derivative instruments including the possibility of taking into account the risk reducing effects of supervisorily recognised contractual netting agreements on potential future credit risks can be achieved only by amending Directive 89/647/EEC;

(16) Whereas to ensure a level playing-field between credit institutions and investment firms competing in the Community, consistency in the supervisory treatment of their respective activities in the area of OTC derivative instruments is necessary and can only be achieved by adaptations of Council Directive 93/6/EEC of 15 March 1993 on the capital adequacy of investment firms and credit institutions [1];

(17) Whereas this Directive is the most appropriate means of attaining the objectives sought and does not go beyond what is necessary to achieve those objectives,

HAVE ADOPTED THIS DIRECTIVE:

Article 1

In Directive 77/780/EEC Article 12(3) shall be replaced by the following:

'3. Member States may conclude cooperation agreements, providing for the exchange of information, with the competent authorities of third countries or with authorities or bodies of third countries as defined in paragraphs (5) and (5a) only if the information disclosed is subject to guarantees of professional secrecy at least equivalent to those referred to in this Article. Such exchange of information must be for the purpose of performing the supervisory task of the authorities or bodies mentioned.

Where the information originates in another Member State, it may not be disclosed without the express agreement of the competent authorities which have disclosed it and, where appropriate, solely for the purposes for which those authorities gave their agreement'.

Article 2

Directive 89/647/EEC is amended as follows:

1. Article 2 shall be amended as follows:

(a) In paragraph (1) the following indent shall be added:

'— "recognised exchanges" shall mean exchanges recognised by the competent authorities which:

(i) function regularly,

(ii) have rules, issued or approved by the appropriate authorities of the home country of the exchange, which define the conditions for the operation of the exchange, the conditions for access to the exchange as well as the conditions that must be satisfied by a contract before it can effectively be dealt on the exchange,

(iii) have a clearing mechanism that provides for contracts listed in Annex III to be subject to daily margin requirements providing an appropriate protection in the opinion of the competent authorities.'

(b) In paragraph (2) the following subparagraph shall be added:

[1] OJ L 141, 11.6.1993, p. 1.

'The competent authorities may also include within the concept of regional governments and local authorities, churches and religious communities constituted in the form of a legal person under public law, in so far as they raise taxes in accordance with legislation conferring on them the right to do so. However, in this case the option set out in Article 7 shall not apply'.

2. In Article 5(3), the first sentence shall be replaced by the following:

'3. In the case of the off-balance-sheet items referred to in Article 6(3), the potential costs of replacing contracts in the event of counterparty default shall be calculated by means of one of the two methods set out in Annex II'.

3. Article 6 shall be amended as follows:

(a) In paragraph (2) the following sentence shall be added:

'The portion of unpaid capital subscribed to the European Investment Fund may be weighted at 20 %'.

(b) Paragraph (3) shall be replaced by the following:

'3. The methods set out in Annex II shall be applied to the off-balance-sheet items listed in Annex III except for:

— contracts traded on recognised exchanges,

— foreign-exchange contracts (except contracts concerning gold) with an original maturity of 14 calendar days or less.

Until 31 December 2006, the competent authorities of Member States may exempt from the application of the methods set out in Annex II over-the-counter (OTC) contracts cleared by a clearing house where the latter acts as the legal counterparty and all participants fully collateralise on a daily basis the exposure they present to the clearing house, thereby providing a protection covering both the current exposure and the potential future exposure. The competent authorities must be satisfied that the posted collateral gives the same level of protection as collateral which complies with paragraph 1(a)(7) and that the risk of a build-up of the clearing house's exposures beyond the market value of posted collateral is eliminated. Member States shall inform the Commission of the use they make of this option'.

(c) In paragraph (4) the following subparagraph shall be added:

'The Member States may apply a 50 % weighting to off-balance-sheet items which are sureties or guarantees having the character of credit substitutes and which are fully guaranteed, to the satisfaction of the competent authorities, by mortgages meeting the conditions set out in paragraph (1)(c)(1), subject to the guarantor having a direct right to such collateral'.

4. Article 7 shall be amended as follows:

(a) in paragraph (1) the following shall be added after the words 'local authorities':

'or secured, to the satisfaction of the competent authorities concerned, by collateral in the form of securities issued by those regional governments or local authorities';

(b) in paragraph (2) the following shall be added after the words 'the latter':

', including collateral in the form of securities'.

5. Article 8(1) shall be replaced by the following:

'1. Without prejudice to Article 7(1) the Member States may apply a weighting of 20 % to asset items which are secured, to the satisfaction of the competent authorities concerned, by collateral in the form of securities issued by Zone A regional governments or local authorities, by deposits placed with Zone A credit institutions other than the lending institution, or by certificates of deposit or similar instruments issued by such credit institutions'.

6. Annexes II and III shall be amended or replaced in accordance with Parts A and B of the Annex to this Directive.

Article 3

Directive 93/6/EEC is amended as follows:

1. Article 2(10) shall be replaced by the following:

'10. "over-the-counter (OTC) derivative instruments" shall mean the off-balance-sheet items to which according to the first subparagraph of Article 6(3) of Directive 89/647/EEC the methods set out in Annex II to the said Directive shall be applied'.

2. Annex II, point 5, shall be replaced by the following:

'5. In order to calculate the capital requirement on their OTC derivative instruments, institutions shall apply Article II to Directive 89/647/EEC. The risk weightings to be applied to the relevant counterparties shall be determined in accordance with Article 2(9) of this Directive.

Until 31 December 2006, the competent authorities of Member States may exempt from the application of the methods set out in Annex II OTC contracts cleared by a clearing house where the latter acts as the legal counterparty and all participants fully collateralise on a daily basis the exposure they present to the clearing house, thereby providing a protection covering both the current exposure and the potential future exposure. The competent authorities must be satisfied that the posted collateral gives the same level of protection as collateral which complies with Article 6(1)(a)(7) of Directive 89/647/EEC and that the risk of a build-up of the clearing house's exposures beyond the market value of posted collateral is eliminated. Member States shall inform the Commission of the use they make of this option'.

Article 4

1. Member States shall bring into force the laws, regulations and administrative provisions necessary for them to comply with this Directive not later than 24 months after the date of its entry into force. They shall forthwith inform the Commission thereof.

When Member States adopt these measures, they shall contain a reference to this Directive or shall be accompanied by such reference on the occasion of their official publication. The methods of making such reference shall be laid down by Member States.

2. Member States shall communicate to the Commission the text of the main provisions of domestic law, which they adopt in the field governed by this Directive.

Article 5

This Directive shall enter into force on the day of its publication in the *Official Journal of the European Communities*.

Article 6

This Directive is addressed to the Member States.

Done at Luxembourg, 22 June 1998.

For the European Parliament	*For the Council*
The President	*The President*
J. M. GIL-ROBLES	J. CUNNINGHAM

ANNEX

A. Annex II to Directive 89/647/EEC is amended as follows:

1. The heading is replaced by the following:

'*ANNEX II*

THE TREATMENT OF OFF-BALANCE SHEET ITEMS';

2. Point 1 is replaced by the following:

'1. Choice of the method

To measure the credit risks associated with the contracts listed in points 1 and 2 of Annex III, credit institutions may choose, subject to the consent of the competent authorities, one of the methods set out below. Credit institutions which have to comply with Article 6(1) of Directive 93/6/EEC must use method 1 set out below. To measure the credit risks associated with the contracts listed in point 3 of Annex III all credit institutions must use method 1 set out below';

3. In point 2, Table 1 is replaced by the following:

'TABLE [a] [b]

Residual maturity [c]	Interest-rate contracts	Contracts concerning foreign-exchange rates and gold	Contracts concerning equities	Contracts concerning precious metals except gold	Contracts concerning commodities other than precious metals
One year or less	0 %	1 %	6 %	7 %	10 %
Over one year, less than five years	0,5 %	5 %	8 %	7 %	12 %
Over five years	1,5 %	7,5 %	10 %	8 %	15 %

[a] Contracts which do not fall within one of the five categories indicated in this table shall be treated as contracts concerning commodities other than precious metals.

[b] For contracts with multiple exchanges of principal, the percentages have to be multiplied by the number of remaining payments still to be made according to the contract.

[c] For contracts that are structured to settle outstanding exposure following specified payment dates and where the terms are reset such that the market value of the contract is zero on these specified dates, the residual maturity would be equal to the time until the next reset date. In the case of interest-rate contracts that meet these criteria and have a remaining maturity of over one year, the percentage shall be no lower than 0,5 %.

For the purpose of calculating the potential future exposure in accordance with step (b) the competent authorities may allow credit institutions until 31 December 2006 to apply the following percentages instead of those prescribed in Table 1 provided that the institutions make use of the option set out in Article 11a of Directive 93/6/EEC for contracts within the meaning of point 3(b) and (c) of Annex III:

Table 1a

Residual maturity	Precious metals (except gold)	Base metals	Agricultural products (softs)	Other, including energy products
One year or less	2 %	2,5 %	3 %	4 %
Over one year, less than five years	5 %	4 %	5 %	6 %
Over five years	7,5 %	8 %	9 %	10 %'

4. In Table 2, the heading in the first row of the third column is replaced by:

'Contracts concerning foreign-exchange rates and gold'.

5. In point 2 the following paragraph is added at the end:

'For methods 1 and 2 the competent authorities must ensure that the notional amount to be taken into account is an appropriate yardstick for the risk inherent in the contract. Where, for instance, the contract provides for a multiplication of cash flows, the notional amount must be adjusted in order to take into account the effects of the multiplication on the risk structure of that contract'.

6. In point (3)(b) the following paragraph is added:

'The competent authorities may recognise as risk-reducing contractual-netting agreements covering foreign-exchange contracts with an original maturity of 14 calendar days or less written options or similar off-balance-sheet items to which this Annex does not apply because they bear only a negligible or no credit risk. If, depending on the positive or negative market value of these contracts, their inclusion in another netting agreement can result in an increase or decrease of the capital requirements, competent authorities must oblige their credit institution to use a consistent treatment.'

7. In point (3)(c)(ii), the first paragraph and the introductory wording and the second paragraph, first indent, are replaced by the following:

'(ii) Other netting agreements

In application of method 1:

in step (a) the current replacement cost for the contracts included in a netting agreement may be obtained by taking account of the actual hypothetical net replacement cost which results from the agreement; in the case where netting leads to a net obligation for the credit institution calculating the net replacement cost, the current replacement cost is calculated as "0";

in step (b) the figure for potential future credit exposure for all contracts included in a netting agreement may be reduced according to the following equation:

$$PCE_{red} = 0{,}4 * PCE_{gross} + 0{,}6 * NGR * PCE_{gross}$$

where:

— PCE_{red} = the reduced figure for potential future credit exposure for all contracts with a given counterparty included in a legally valid bilateral netting agreement,

— PCE_{gross} = the sum of the figures for potential future credit exposure for all contracts with a given counterparty which are included in a legally valid bilateral netting agreement and are calculated by multiplying their notional principal amounts by the percentages set out in Table 1,

— NGR = "net-to-gross ratio": at the discretion of the competent authorities either:

(i) separate calculation: the quotient of the net replacement cost for all contracts included in a legally valid bilateral netting agreement with a given counterparty (numerator) and the gross replacement cost for all contracts included in a legally valid bilateral netting agreement with that counterparty (denominator), or

(ii) aggregate calculation: the quotient of the sum of the net replacement cost calculated on a bilateral basis for all counterparties taking into account the contracts included in legally valid netting agreements (numerator) and the gross replacement cost for all contracts included in legally valid netting agreements (denominator).

If Member States permit credit institutions a choice of methods, the method chosen is to be used consistently.

For the calculation of the potential future credit exposure according to the above formula perfectly matching contracts included in the netting agreement may be taken into account as a single contract with a notional principal equivalent to the net receipts. Perfectly matching contracts are forward foreign exchange contracts or similar contracts in which notional principal is equivalent to cash flows if the cash flows fall due on the same value date and fully or partly in the same currency.

In the application of method 2, in step (a)

— perfectly matching contracts included in the netting agreement may be taken into account as a single contract with a notional principal equivalent to the net receipts, the notional principal amounts are multiplied by the percentages given in Table 2'.

B. Annex III to Directive 89/647/EEC is replaced by the following:

'*ANNEX III*

TYPES OF OFF-BALANCE-SHEET ITEMS

1. Interest-rate contracts:
   (a) single-currency interest rate swaps,
   (b) basis-swaps,
   (c) forward-rate agreements,
   (d) interest-rate futures,
   (e) interest-rate options purchased,
   (f) other contracts of similar nature.
2. Foreign-exchange contracts and contracts concerning gold:
   (a) cross-currency interest-rate swaps,
   (b) forward foreign-exchange contracts,
   (c) currency futures,
   (d) currency options purchased,
   (e) other contracts of a similar nature,
   (f) contracts concerning gold of a nature similar to (a) to (e).
3. Contracts of a nature similar to those in points 1(a) to (e) and 2(a) to (d) concerning other reference items or indices concerning:
   (a) equities,
   (b) precious metals except gold,
   (c) commodities other than precious metals,
   (d) other contracts of a similar nature'.