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**CEBS's guidelines regarding revised Article 3 of  
Directive 2006/48/EC**

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## Introduction

1. Article 3 of Directive 2006/48/EC (hereafter 'Article 3'), as adopted on 14 June 2006, allows Member States to provide special prudential regimes for credit institutions which have been permanently affiliated to a central body since 15 December 1977, provided that those regimes were introduced into national law by 15 December 1979. These time limits prevented Member States, especially those which acceded to the European Union after 1980, from introducing or maintaining such special prudential regimes for similar affiliated credit institutions which were set up in their territories.
2. In 2009, the European Parliament and the Council decided it was appropriate to remove the time limits set out in Article 3,<sup>1</sup> in order to provide equal conditions for competition between credit institutions in Member States. This means that, from 31 December 2010, all Member States can provide the special prudential regime set out in Article 3 for all existing or future affiliated credit institutions that meet the conditions set out in that Article. In this context, CEBS was invited to develop guidelines in order to enhance the convergence of supervisory practices in this regard<sup>2</sup>.
3. On 13 July 2010 CEBS published its draft proposals for the supervisory guidelines regarding the application of the revised Article 3 for consultation (CP41);<sup>3</sup> the public consultation closed on 27 August 2010 and six responses were received.<sup>4</sup> CEBS has considered the feedback received and reviewed the proposals put forward for consultation. As a result of that review CEBS has set out in this paper its guidelines to enhance the convergence of supervisory practices in the application of the revised Article 3.
4. In addition, while developing its guidelines, CEBS has benefited from technical input and comments provided by industry experts nominated by the European Association of Co-operative Banks (EACB).

## Objectives, methodology and scope

5. The objectives of the guidelines set out in this paper are to:
  - a) enhance the convergence of supervisory practices on the application of Article 3 across the EU; and
  - b) create more transparency for market participants.

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<sup>1</sup> Article 3 of Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 was amended by Directive 2009/111/EC of the European Parliament and of the Council of 16 September 2009 (published under: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:302:0097:0119:EN:PDF>). The amended Article 3, which includes a national discretion that can be applied from 31 December 2010, is set out in the Annex to this consultation paper.

<sup>2</sup> Cf. Recital 2 of the amending Directive 2009/111/EC of the European Parliament and of the Council of 16 September 2009.

<sup>3</sup> The CP41 is published on CEBS's website: <http://www.c-eps.org/Publications/Consultation-Papers/All-consultations/CP41-CP50/CP41.aspx>

<sup>4</sup> The responses to CP41 are published on CEBS's website: <http://www.c-eps.org/Publications/Consultation-Papers/All-consultations/CP41-CP50/CP41/Responses-to-CP41.aspx>

6. It is CEBS's understanding that the main purpose of Article 3 is to make it clear that the central body and its affiliates form a unity and thus to ensure, where appropriate, equal treatment of Groups as defined in this article *vis-a-vis* credit institutions with a (significant) number of branches. The guidelines have to be read against this background.
7. CEBS acknowledges that there may be institutions affiliated to groups which do not fulfil the requirements of Article 3, or which fulfil those requirements but do not apply for derogations under Article 3 and, therefore, meet all requirements of Directive 2006/48/EC and are supervised on a solo basis. Nevertheless, the decision on the application of Article 3 is incumbent on each Member State's competent authority.

## **Implementation date**

8. Member States that wish to allow the use of the special prudential regime set out in the revised Article 3 have to transpose it into their national law.<sup>5</sup>
9. CEBS expects its Members, who wish to make use of the amended Article 3 from 31 December 2010, to transpose CEBS's final guidelines into their national legal/policy framework and apply them, at the very latest, six months after their publication date. If Members decide to make use of the amended Article 3 after 31 December 2010, CEBS expects the application of its guidelines at the very latest at the time when the revised Article 3 is implemented in their national legislation.

## **Guidelines for the convergence of supervisory practices on the application of revised Article 3 of Directive 2006/48/EC**

10. CEBS understands that the competent national authorities (of the Member States that decided to transpose Article 3) are responsible for assessing the Group's<sup>6</sup> compliance with the conditions in Article 3. Only in the case where the competent authority is satisfied that the Group meets the conditions in Article 3 can the derogations under Article 3 be granted.
11. CEBS believes that for the convergent application of Article 3 further guidance on the following aspects is necessary:<sup>7</sup>
  - A) clarification of what should be understood by 'permanently affiliated to a central body' (Article 3 (1));
  - B) clarification of what should be understood by 'the commitments of the central body and affiliated institutions are joint and several liabilities or

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<sup>5</sup> See Article 4 of the amending Directive 2009/111/EC of the European Parliament and of the Council of 16 September 2009.

<sup>6</sup>In these guidelines, 'Group' should be understood to mean the central body and its affiliated institutions as a whole.

<sup>7</sup> Article 3, as amended by Directive 2009/111/EC, is set out in the annex to this paper.

the commitments of its affiliated institutions are entirely guaranteed by the central body' (Article 3 (1) (a));

- C) clarification of the relationship between the requirements and exemptions in Article 3 (1) and the further requirements and exemptions in Article 3 (2);
- D) clarification on whether 'monitored as a whole on the basis of consolidated accounts' (Article 3 (1) (b)) refers to the preparation of consolidated accounts in accordance with applicable accounting requirements or with the preparation of consolidated reporting for the purposes of prudential supervision;
- E) clarification on which type of 'instructions' might be issued by the management of the central body (Article 3 (1) (c)); and
- F) clarification on the use of the EU passport (Article 3 (2)).

#### **A) Concept of 'permanently affiliated to a central body'**

- 12. From a prudential perspective, the permanence of the affiliation to a central body is essential to the stability of the whole Group. However, CEBS acknowledges that, in specific circumstances, it is acceptable that an affiliated institution could opt to leave the Group or could be excluded from the Group.
- 13. CEBS believes that a common understanding of the concept of 'permanence' and, therefore, of the circumstances which could lead to the voluntary exit or exclusion of an affiliated institution from the Group will contribute to the convergent application of Article 3 across Members States.
- 14. The focus of Article 3 and, therefore, of CEBS's guidelines, is on the prudential aspects of the concept of 'permanent affiliation'. However, CEBS acknowledges that there are usually other elements and arrangements, irrespective of what is required under Article 3, that link the individual affiliated institutions and the Group, making their exit difficult and costly. The following aspects are examples illustrating these links:
  - use of an integrated IT system, including all the major ledgers, payment systems, accounting, solvency accounting, etc;
  - use of integrated liquidity management and reserves, short and long-term funding (other than deposit accounts);
  - use of centralized treasury functions;
  - use of an integrated inter-institutional guarantee system and fund; and
  - use of a common brand name, product development, advertising and marketing.

15. In CEBS's view, the central body may propose to exclude affiliated institutions from the Group if one of the following conditions is met:
  - a) the affiliated institutions do not comply with the Articles of Association<sup>8</sup> and other legal and regulatory frameworks applicable to them; or
  - b) the affiliated institutions do not follow the instructions and do not respect the 'supervisory' powers of the central body and the requirements these powers are intended to ensure.
16. The central body should always communicate its intention in advance to the competent supervisory authority. The decision to exclude an affiliated institution is to be made in accordance with the relevant requirements set by the competent supervisory authority and should be disclosed publicly by the central body.
17. In addition, the proposal from the central body should always take into account the extent to which the exit of an affiliated institution will affect the solvency or the liquidity of the Group and its individual entities.
18. In a case where an affiliated institution wishes to voluntarily exit the Group, the competent supervisory authority has to ensure that there is no material negative impact on the fulfilment of the prudential requirements of the system applied to the central body and its remaining affiliates. This assessment should consider, among other issues, the opinion of the central body. Naturally, the exiting affiliate will have to comply with all the prudential requirements as a stand alone entity (Article 6 *et seq.* of Directive 2006/48/EC should apply *mutatis mutandis*).

## **B) Guarantee**

19. Paragraph (a) of Article 3 (1) states that 'the commitments of the central body and affiliated institutions are joint and several liabilities or the commitments of its affiliated institutions are entirely guaranteed by the central body'. In this regard the system of guarantees may provide for:
  - a) a guarantee by the central body of each affiliated institution;
  - b) a two-way guarantee (i.e. a guarantee by the central body of each affiliated institution and vice-versa); or
  - c) a cross-guarantee (i.e. a guarantee (a) by the central body of each affiliated institution, (b) a guarantee by each affiliated institution of the central body, and (c) a guarantee by each affiliated institution and the central body of all other affiliated institutions).
20. In any case, the applicable arrangements under a) to c) should ensure that there are no legal or practical impediments to the prompt transfer of own funds and liquidity within the Group to ensure that the obligations to creditors of the

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<sup>8</sup> 'Articles of Association' means all the documents and instruments governing the affiliation's arrangements.

central body and its affiliates can be fulfilled. The Group as a whole must be able to grant the support necessary under its applicable arrangements from funds readily available.

21. In addition, in accordance with the applicable guarantee system, applicable law and/or the Articles of Association, the Group should ensure that no liabilities or commitments are left unresolved when one of the affiliated institutions exits the Group. Supervisors may provide for a short period after the exit to comply with this requirement.

### **C) Relation of the requirements and exemptions in Article 3 (1) and (2)**

22. Article 3 (1) exempts the affiliated institutions from the application of the requirements of Articles 7<sup>9</sup> and 11(1)<sup>10</sup> of Directive 2006/48/EC under certain conditions further defined under paragraph 1. In particular, Article 3 (1) (b) requires that the solvency and liquidity of the central body and of all the affiliated institutions are monitored as a whole on the basis of consolidated accounts. Article 3 (2) exempts those affiliated institutions from the provisions of Articles 9<sup>11</sup> and 10<sup>12</sup>, and also Title V, Chapter 2, Sections 2<sup>13</sup>, 3<sup>14</sup>, 4<sup>15</sup>, 5<sup>16</sup> and 6<sup>17</sup>, and Chapter 3<sup>18</sup> provided that, without prejudice to the application of those provisions to the central body, the central body together with its affiliated institutions is subject to those provisions on a consolidated basis.
23. The exemptions in Article 3 (2) are more comprehensive than the exemptions in Article 3 (1). Therefore, CEBS is of the view that Article 3 (2) should be regarded as an extension to the provisions of Article 3 (1). Consequently, it is not possible to benefit from the exemptions in Article 3(2) without complying with all of the conditions in Article 3(1) first.

### **D) Consolidated financial statements vs. consolidated prudential reporting**

24. Article 3 (1) (b) sets a requirement for the solvency and liquidity of the central body and of all the affiliated institutions to be monitored as a whole on the basis of consolidated accounts. It is CEBS's view that the requirement for the monitoring of solvency and liquidity on the basis of consolidated accounts should be viewed from a prudential supervisory perspective. For the purposes of

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<sup>9</sup> Which requires applications for the authorisation to be accompanied by a programme of operations setting out, inter alia, the types of business envisaged and the structural organisation of the credit institutions.

<sup>10</sup> Which requires that the credit institution has at least two persons who effectively direct its business.

<sup>11</sup> Which sets out the requirements for the 'initial capital' of a credit institution.

<sup>12</sup> Which requires that the credit institution's own funds do not fall below its 'initial capital'.

<sup>13</sup> 'Provision against risks'.

<sup>14</sup> 'Minimum own funds requirements for credit risk'.

<sup>15</sup> 'Minimum own funds requirements for operational risk'.

<sup>16</sup> 'Large exposures'.

<sup>17</sup> 'Qualifying holdings outside the financial sector'.

<sup>18</sup> 'Credit institutions' assessment process'.

prudential supervision, the central body and the affiliated institutions should be required to prepare consolidated accounts for reporting purposes in accordance with Article 133 *et seq.* of Directive 2006/48/EC. The assessment as to whether the central body must prepare consolidated financial accounts should be performed on the basis of the accounting framework to which it is subject under Regulation n° 1606/2002 of 19 July 2002 on the application of International Accounting Standards or Directive 86/635/EEC.

## **E) Type of 'instructions' that can be issued by the management of the central body**

25. Article 3 (1) (c) allows the management of the central body to issue instructions to the management of affiliated institutions. CEBS believes that the main purpose of these instructions should be to ensure that the affiliated institutions comply with the requirements of the legislation and of the Articles of Association with a view to safeguarding the soundness of the Group.
26. The central body should monitor and 'supervise' the compliance of its affiliated institutions with its instructions. In this context, CEBS acknowledges that the control mechanisms and instruments which form part of the Group's internal governance, set up by the central body, help to ensure that affiliated institutions comply with the relevant rules of law, prudential requirements and the instructions issued by the central body.
27. It should be stressed that the 'supervisory powers' of the central body (c.f. Article 3 (1)) do not impinge on or interfere with the supervisory powers of the competent supervisory authority over the central body and, when appropriated, over the affiliated institutions.
28. It is CEBS's view that the central body should issue instructions to its affiliated institutions with the aim of ensuring the Group's compliance with the regulatory requirements that the affiliated institutions individually are exempted from pursuant to Article 3. To ensure this, the central body will:
  - a) take all the necessary measures to ensure that the Group complies with the prudential requirements; and
  - b) ensure that the laws and regulations applying to the Group are implemented and complied with accordingly.
29. In particular, it is CEBS's view that the instructions that the management of the central body can issue should cover, as a minimum, the following objectives:
  - a) ensuring administrative, technical and financial supervision of the affiliated institutions;
  - b) ensuring compliance with all applicable prudential rules and, in particular, ensuring the liquidity and capital adequacy of the Group;

- c) ensuring the fit and properness of the senior management of affiliated institutions. This should be done in conformity with the applicable rules as defined by the competent supervisory authorities;
- d) ensuring the preparation of prudential reports for the supervisors by the Group;
- e) defining the policy and the principles of the risk evaluation, measurement and control procedures (including stress testing) for the Group and for the individual affiliated institutions. The aim is to ensure that the policy and strategic purposes of each affiliated institution are in line with the Group's policy and strategic purposes, and also with its risk appetite, capacity and overall objectives as defined by the central body;
- f) defining the internal control procedures for the Group and each of the affiliated institutions;
- g) defining criteria or rules for the on-going business of the affiliated institutions, including credit-granting authorisations, credit monitoring and investments;
- h) defining criteria or rules for the provision of financial assistance to the affiliates; and
- i) defining criteria or rules regarding the creation of new establishments and/or cross-border activities.

## **F) Use of the EU passport**

- 30. The second paragraph of Article 3 (2) states that if the exemption under Article 3 (2) is granted, the EU passport under Article 23 of Directive 2006/48/EC shall apply to the whole Group as constituted by the central body and its affiliated institutions.
- 31. CEBS's is of the opinion that:
  - a) in order to be able to use the EU passport, the central body and its affiliated institutions form a unity, which, as a whole, is regulated and supervised on a consolidated basis and which fulfils the requirements of the Directive 2006/48/EC;
  - b) accordingly, there should be no difference from a material point of view between the regulation and supervision of this Group as defined in footnote 6 and any other credit institution or group of credit institutions;
  - c) the affiliated institutions can apply to the central body for the use of the EU passport. In this case, it is the responsibility of the central body to

reject or accept the application. In the latter case, the central body<sup>19</sup> shall process the notification to the competent supervisory authority of the Home Member State, specifying that the use of the EU passport (freedom to provide services or the establishment of a branch) is being made by the whole group through one of its affiliate (indicating which);<sup>20</sup>

- d) the central body could use the EU passport on its own, provided that it is licensed as a credit institution and fulfils the respective requirements of Directive 2006/48/EC on a solo basis; and
  - e) there is no distinction, in the context of Article 3, between the freedom to provide services and the establishment of a branch. Therefore, this rule applies equally to both situations.
32. CEBS makes it clear that it is its understanding that, other than on the terms set out above, affiliated institutions covered by the exemption provided in Article 3 cannot make use of the EU passport and process passport notifications to the competent supervisory authority of the Home Member State on an individual basis and on their exclusive initiative.
33. This guidance does not apply in the case of affiliates not relying on Article 3 (i.e. which meet all requirements of Directive 2006/48/EC and are supervised on a solo basis), which are able to use the EU passport and notify on an individual basis. A new notification, in the format as outlined in footnote 20, has to be made when those affiliates intend to rely on Article 3.

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<sup>19</sup> The central body may not be licensed as a credit institution (as currently in Finland) or its licence may be restricted to act as a central body (as currently in Denmark).

<sup>20</sup> The required notification under Article 25 and Article 28 should make clear exactly the nature and arrangement of the central body and its affiliated institutions - including which entity or entities the programme of operations actually covers – and confirmation of how the requirements of Article 3 and these guidelines are met. In addition, the standard notification form for cross-border services and for branch establishments should follow CEBS's guidelines for passport notifications (Annex 1 and 2), which are published on CEBS's website: <http://www.cebs.org/getdoc/364b9c1a-c8c4-4e84-8b20-1195707c08f9/CEBS-Passporting-Guidelines.aspx> ).

## Annex

### **Article 3 of Directive 2006/48/EC (amended by Directive 2009/111/EC):**

"1. One or more credit institutions situated in the same Member State and which are permanently affiliated to a central body which supervises them and which is established in the same Member State, may be exempted from the requirements of Articles 7 and 11(1) if national law provides that:

(a) the commitments of the central body and affiliated institutions are joint and several liabilities, or the commitments of its affiliated institutions are entirely guaranteed by the central body;

(b) the solvency and liquidity of the central body and of all the affiliated institutions are monitored, as a whole, on the basis of consolidated accounts; and

(c) the management of the central body is empowered to issue instructions to the management of the affiliated institutions.

2. A credit institution referred to in the first subparagraph of paragraph 1, may also be exempted from the provisions of Articles 9 and 10, and also Title V, Chapter 2, Sections 2, 3, 4, 5 and 6 and Chapter 3, provided that, without prejudice to the application of those provisions to the central body, the whole, as constituted by the central body, together with its affiliated institutions, is subject to those provisions on a consolidated basis.

In case of exemption, Articles 16, 23, 24, 25, 26(1) to (3) and 28 to 37 shall apply to the whole as constituted by the central body together with its affiliated institutions."