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20 October 2016



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EBA/2016/D/944

Follow up questions to EBA on Deutsche Bank Leverage Ratio

Dear Mr Giegold

Thank you for your follow-up questions on the leverage ratio of Deutsche Bank reported in the context of the 2016 EU-wide stress test and on the treatment of the sale of its stake in Hua Xia Bank.

On the calculation of the leverage ratio, you ask whether the calculation of the requirement should be reconsidered, taking into account the indicator developed by the FDIC in its Global Capital Index, the ratio of “adjusted tangible equity to adjusted tangible assets”. I believe that the definition of the leverage ratio contained in Article 429 of Capital Requirements Regulation (CRR) (EU) No 575/2013 as per Delegated Regulation (EU) 2015/62 of 10 October 2014 is appropriate. It is based on the international standard agreed by the Basel Committee on Banking Supervision (BCBS) and used, for regulatory purposes, in all other major jurisdictions, including the United States.

My understanding is that the indicator developed by the FDIC aims at showing the significant differences in balance sheet measures calculated according to different accounting standards – in particular, Financial Reporting Standards (IFRS) vs. Generally Accepted Accounting Principles (US GAAP). Great effort has been put by the supervisory community in identifying a measure of leverage that is prudentially sound and neutral with respect to the different accounting standards. This is essential to allow for meaningful international comparisons. Departing from this definition would require not only a revision of EU level 1 and 2 texts, but in all likelihood also of the Basel Committee’s standard. Furthermore, if we had to move to a definition based on accounting definitions in the EU we would have to address the differences between IFRS and national GAAPs used in several Member States.

As mentioned in my previous letter, the main differences between the two definitions of the leverage ratio are that the accounting indicator published by the FDIC does not include in the numerator Additional Tier 1 capital instruments and adopts a different concept of netting for derivatives instruments and off-balance sheet exposures. The EBA has recently published a Report on the leverage ratio requirements under Article 511 of the CRR¹. As part of the recommendations given in this extensive report the EBA confirms that the numerator should consist of Tier 1 capital and suggests no immediate changes to the calculation rules of the denominator.

The use of Tier 1 as the relevant yardstick is justified as it includes all “going concern” capital instruments, i.e. those that are able to absorb losses and constrain payments before the bank reaches the point of non-viability. This is consistent with the concept of the leverage ratio as a backstop to risk-based requirements and as a structural balance-sheet measure.

Regarding the denominator, possible changes to the treatment of derivatives and off-balance sheet items have been assessed and our analysis has not indicated a need to revise the current rules. In addition, an EBA report published in March 2014 included an analysis of alternative treatments on netting of security financing transactions and recognition of cash variation margin for derivatives and recommended to implement the leverage ratio as is currently specified. The prudential criteria developed by the BCBS effectively neutralise differences in the accounting treatment for the netting of items such as derivatives and securities financing transactions and develop a sound, common framework applicable in different jurisdictions.

As to your second question regarding the treatment of Deutsche Bank in the stress test please consider the following observations.

The decision to allow for “one-off” adjustments was discussed at length in our Board of supervisors and eventually included in the stress test methodology for the 2016 exercise. One-offs are only permitted for a narrow set of events and are designed to avoid anomalies in the forward looking stress test in cases in which relevant events had already taken place in 2015, before the starting point for the exercise. For instance, this possibility is used when a bank has sold a subsidiary or a relevant line of business but would be constrained to project forward the administrative and operational costs for that entity for the full three year period covered by the stress test. The decision for each one-off is the responsibility of the relevant competent authority and is reviewed at the EBA’s Board of Supervisors. Competent authorities approved one-offs for 21 banks. All one-offs are reported in our publication of the stress test results. We are not aware whether other banks requested one-off adjustments, which have not been granted by competent authorities.

¹ [http://www.eba.europa.eu/documents/10180/1360107/EBA-Op-2016-13+\(Leverage+ratio+report\).pdf](http://www.eba.europa.eu/documents/10180/1360107/EBA-Op-2016-13+(Leverage+ratio+report).pdf)

It is correct that the stress test results for Deutsche Bank include the sale of its stake in Hua Xia Bank. Based on the Deutsche Bank's financial statements, that sale increases the CET1 ratio in 2015 by approximately 40bps. The SSM submitted the Hua Xia case as a one-off. However, the EBA staff raised concerns as to its consistency with the static balance sheet assumption of the methodology. The contract had been signed at the end of December 2015, and a loss arising from the sale was already reported in the 2015 accounts, but the transaction was to be closed in 2016. Accordingly, the EBA's Board of Supervisors was requested to express its views in a vote and approved this exception. The issue is transparently explained in a footnote². Competent authorities including the SSM did not communicate any other similar cases to the EBA.

I hope this addresses your questions. As you know the EBA has worked hard to develop a consistent methodology for the EU-wide stress test resulting in comparable results. We also aim to be fully transparent on the methodology applied and on any adjustments that were carried out. Please feel free to contact me if you require any further information.

Yours sincerely

(signed)

Andrea Enria

² http://www.eba.europa.eu/documents/10180/1519983/EBA_TR_DE_7LTWFZYICNSX8D621K86.pdf
<http://www.eba.europa.eu/documents/10180/1532819/2016-EU-wide-stress-test-Results.pdf>