

**EBF COMMENTS ON THE EBA CONSULTATION PAPER  
DRAFT RTS ON OWN FUNDS – PART THREE**

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**GENERAL COMMENTS**

1. Whilst we support the overall aim to prevent that portions of capital be levered multiple times, we believe it to be equally essential for the regulatory framework to avoid that banks be required (i) to deduct items multiple times and/or (ii) to risk-weight items that need to be deducted from capital. We ask the EBA to accept this as a basic guiding principle throughout the RTS.
2. Regarding the treatment of opaque indirect holdings, we understand, generally speaking, the logic underlying the various proposals for calculating that are being made. We would nevertheless like to encourage the EBA to examine if there would be ways to make them less burdensome from an operational point of view as well as from an economic point of view.
  - From an operational point of view, both the default method and the structure-based approach are very burdensome. Thresholds should be introduced to reduce the burden. The focus should be on significant holdings.
  - From an economic point of view, especially the treatment of positions where no look through is possible at all (even under very burdensome conditions), is far too conservative. The requirement to treat these opaque positions in the same way as fully owned investment instruments illustrates this perfectly. Along with the strict limits set in the RTS 2013-01 (near final draft) for the application of the structured-based approach, it leads to disproportionate results. We therefore propose a more differentiated treatment below (see under Q3).
3. For determining the exposures in synthetic holdings to be deducted, the notional amount is a misleading number in most of the cases. We, therefore to use the delta-equivalent to positions with the character of options (Q5)
4. The CRR refers to CET1-instruments which the institution owns (Article 43 (a) CRR) regarding the definition of "significant investments". Therefore, we believe it to be more adequate to refer to positions that lead to a direct relationship (direct holdings) only, when determining significant investments (Q7).
5. Addressing securitisation SPEs as intermediate entities does not seem appropriate. These positions are better reflected by the securitisation framework (see also our comments below, under Q1).
6. The Regulation stipulates that the amount of eligible minority interests of a subsidiary that is included in consolidated Common Equity Tier 1 capital needs to be determined by taking into account "the amount of Common Equity Tier 1 capital of that subsidiary required to meet the sum of the requirement laid down in:
  - point (a) of Article 92(1);
  - the requirements referred to in Articles 458 and 459;
  - the specific own funds requirements referred to in Article 104 of Directive 2013/.../EU;

- **the combined buffer requirement defined in point (6) of Article 128 of Directive 2013/.../EU;**
- **the requirements referred to in Article 500**and
- **any additional local supervisory regulations in third countries insofar as those requirements are to be met by Common Equity Tier 1 capital**". (Article 84, §1, of the final version of the Regulation).

We note, however, that neither Article 34 b) or the numerical example provided in Annex include in the calculation the various building blocks which we have highlighted in bold above. As a result, the proposed Article 34b is not consistent with the legislative text which it seeks to implement.

We fear that the EBA's interpretation of Article 84 does not allow for the recognition of the local prudential requirements when these are higher than the requirements at consolidated level. We believe that Article 84 implies that the only difference in the calculation between (i) and (ii) is the elimination of intragroup positions. The minimum ratio to apply should be the higher of the consolidated and the local capital ratio.

7. Binding Technical Standards are expected to deliver harmonised solutions.

The Consultation paper fails to achieve harmonisation where it proposes to clarify the concept of "synthetic holdings" in specifying that "*synthetic holdings shall include, but are not limited to the following forms: ...*" (Article 14a, §2). Because, as a result, the various instruments are being listed in a mere illustrative way, national supervisors are explicitly being authorised to consider nevertheless instruments which are not on the list as "synthetic holdings".

This is not in accordance with the Single Rulebook which the EBA is supposed to produce.

Our understanding is that the Consultation Paper has preferred including a mere illustrative list to avoid opening loopholes- which we believe to be a comprehensible approach. However, such an approach necessarily needs to be accompanied by measures aiming at (i) introducing discipline as to the way in which national supervisors make use of the possible discretion which is being provided to them and (ii) providing transparency as to the way in which national supervisors have made use of it. It would, therefore, be essential for the forthcoming RTS to provide for a process obliging (i) national supervisors to notify the EBA of instances in which they have qualified as "synthetic holdings" instruments which are not on the list referred to in Article 14a, §2 and (ii) the EBA to submit a Report to the European Commission, the European Council and the European Parliament, three years after the entry into force of the RTS, providing an overview of the notifications which it has received as a consequence and making proposals aiming at completing the list provided for in Article 14a, §2.

Also in Article 14 a, § 1, the term "but are not limited to" should be deleted. Such a modification is in this case quite meaningless to include in the generic definition of "indirect exposures" that is being put forward in Article 14 a, § 1.

## REPLIES TO THE QUESTIONS RAISED

### Q01: Are the provisions of Article 14a sufficiently clear? Are there issues which need to be elaborated further?

- The Consultation Paper proposes that the concept of “Intermediate entities” would include: “Mutual funds, investment funds, pension funds, index funds or securitisation special purpose entities that hold capital instruments of financial sector entities” [Article 14a, §1, (a)].

Where securitisation SPEs are concerned, we fully support the concerns that the EBA seeks to address: such positions should indeed be made transparent whilst the risks resulting from them should be adequately considered. However,

- (i) a sufficient degree of transparency has already been introduced in the existing legislative framework governing securitisation transactions by means of extensive due-diligence-requirements (see in particular Article 395 CRR).
- (ii) the risk resulting from securitisation exposures is – in addition to the risks of the securitised portfolio (including possible holdings) – determined by the thickness and seniority of the individual tranches. The CRR allows for several complex methods to calculate this risk, thereby ensuring that the risks are considered in an appropriate way.

Those risks should, therefore, exclusively be dealt with by the securitisation framework instead of through the calculations that are being proposed of the holding positions (and which we believe to be insufficient to represent the specific risk resulting from securitisation exposures).

Against this backdrop, we would like to suggest amending Article 14a, §1, (a) as follows:

“the Intermediate entities (...) shall include: (a) Mutual funds, investment funds, pension funds, index funds or ~~securitisation~~ securitisation special purpose entities (*other than securitisation SPE's*) that hold capital instruments of financial sector entities; “

- We fail to understand why Article 14a, §22, (c) proposes that “call options purchased” be considered as synthetic holdings which necessarily need to be deducted – considering that purchased options leave it up to the discretion of the institution whether the option will be exercised or not..
- The CRR provides for a 10%-threshold to the sum of holdings of non-significant investments. To examine if that threshold is effectively being met, the CRR includes a set of arrangements which result in making the required calculations extremely complex and burdensome.

We would like to strongly recommend introducing an easy (albeit conservative) rule of thumb which would avoid that institutions would need to go through those complex calculations whenever it is pretty obvious that the set threshold is not being met. We would like to suggest, more particularly, that if the total of holdings in potentially relevant intermediate entities would not exceed the 10% threshold, the exact calculation of a holding in a specific instrument, would not need to be undertaken.

- Regarding the list of indirect and synthetic positions we ask for a clarification that not listing short positions does not mean that no netting of long and corresponding short positions is allowed. In other words: clarify that netting (in line with CRR) is allowed

- The examples that are included in the explanatory text provide clarity about the interpretation of the RTS text. We would like to strongly suggest that the EBA would include the examples in an annex to the final RTS.

**Q02: Provisions included in paragraph 1 of the following Article 14a refer in particular to pension funds. These provisions have to be read in conjunction with the deductions referred to in Article 33(e) of the CRR. Would you see any cases where there might be an overlap between the two types of deductions? Please describe precisely these situations and the nature of the problem.**

It would be useful if the EBA could include examples on:

- how to treat the deduction of holdings. Holdings are to be deducted either via CRR Article 33 (i) or CRR Article 33 (h), or still, alternatively, Article 14d could be used. An example of how article 14d is to be applied in practice would particularly be welcomed.
- how the calculation works for structures where both own funds and other liability instruments have been provided to an intermediate entity.

A “net asset” that results from offsetting for balance sheet purposes pension assets with associated pension provisions needs to be deducted (Article 36, §1, e and Article 41, §1, a). In addition, the total - that means “without offsetting” - pension assets have to be considered as risk and/or holding positions. To avoid a double counting - -as clarified by EBA<sup>1</sup>- it seems appropriate to reduce the assessment base (RWA) and/or the gross amount (holding positions) of the assets by the portion already deducted as "net asset".

Example:

Pension assets (before offsetting):	1000
thereof positions in FSE:	100
Pension provisions (before offsetting):	800
Net asset on the bank’s balance sheet (after offsetting):	200

- ⇒ Deduction amounting to 200 (max [FSE-Positions (100); Net asset (200)])
- ⇒ Recognition of pension assets as RWA / holding position equal to non-deductible amount, that is 800, as long as non-deductible amount is not further reduced by FSE-Positions. If this is the case, the RWA-positions needs to be reduced further.

**Q03: Please provide also some input on the potential impact? What would be the size of the deduction of defined benefit pension funds under the treatment proposed in the following Article? Would the treatment cause a change in the investment policy of the pension fund with regard to such holdings, or have any other consequences for the operation of the defined benefit pension scheme?**

The recognition of pension assets in conjunction with the implicit obligation to look-through to single assets results in an enormous operative burden. The reason being that the trustees - that are entrusted with the management of those pension assets – act very independently. Reporting (e.g. for the purpose

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<sup>1</sup> See page 66 regarding Question 6 of the near final version of its draft Regulatory Technical Standards, [Part 1]: “The EBA agrees on the principle that assets that are deducted should not be subject to a risk weight.”

of annual reports) is often done by independent actuaries. Direct automatic linking of single transactions, which is required to look-through to single assets is practically (and legally) not possible.

Furthermore, the structured-based approach is only applicable under the precondition that a look-through is too “operationally burdensome”. The near final draft of RTS 2013-01 included thresholds depending on the CET1 of the institution (2% for the individual net exposure arising from index holdings (and according to the CP at hand also for all other indirect exposures, that refer to a multitude of underlying), 5% for the aggregated net exposure arising from index holdings that need to be looked-through, 10% for the aggregated net exposure arising from index holdings including all other non-significant investments) that are practically impossible to meet given the partly very high volumes in pension assets.

The consequence, which is to treat the entire opaque position as a 100%-investment in own funds, seems - especially for pension funds – disproportionate, taking into account that a trustee is usually prohibited to directly invest in instruments of the institution to protect pension beneficiaries.

We would welcome a more amplified applicability for the structured-based approach. It should differentiate the following cases:

1. Where the bank is able to ensure that no (for deduction) relevant positions are included in the exposures (as this is the case for funds of bonds) a risk weighting of the exposures is sufficient.
2. Where the bank is able to ensure that no CET1 instruments of other FSE are included in the exposures, the treatment according to non-significant investments in FSE will be applied, while positions in own CET1-positions of the bank are deducted.
3. for cases of aggregated reporting, positions in own and other CET1-positions are treated according to the respective rules for deduction. Regarding other CET1 investments, they are treated as significant investments.
4. For positions where the bank has no transparency at all, the relevant caps of RTS 2013-01 (near final) are applied. The investments have to be deducted – as it is the case for own CET1 instruments. Nevertheless, there should be a grandfathering rule. At least for positions from pension schemes which have been build up before January 1<sup>st</sup> 2014. Thereby, a bank does not need to do full deductions but may risk weight these positions with 250%.

**Q04: Do you agree with the examples of synthetic holdings provided in paragraph 2 of the following Article 14a? Should other examples be added to this list?**

See our comments above – under “General Comments”, n° 7 - which highlight that the EBA proposals seem reasonable but may fail to achieve the expected uniformity and strongly suggest establishing an administrative process aiming at avoiding arbitrariness and introducing transparency.

**Q05: Are the provisions contained regarding synthetic holdings in paragraph 2 of the following Article 14a and in Article 14e sufficiently clear? Do you agree that the amount to be deducted shall be the notional amount? Would you see any situations where another amount shall be used?**

We would like to strongly suggest the EBA to include examples in the annex of the final RTS.

Article 14e proposes that the amount to be deducted from Common Equity Tier 1 items referred to in points (f), (h) and (i) of Article 33(1) of the CRR shall be **the notional amount** of the relevant instruments.

The nominal amount is not appropriate for many occasions. For example, for forward contracts no notional amount is applied. Instead, number of transactions, subscription ratio and market price are the relevant numbers.

Where options are concerned, using the notional amount would result in overestimating the risk inherent in such positions whenever it concerns long-positions. It needs to be taken into account, moreover, that using the notional amount would provide incentives to institutions to create short-positions by concluding option contracts that would lead to a significant decrease in net holding positions due to the recognition of the notional. Based on the fact that the probability to exercise is not considered, such positions could be concluded way “out of the money” and, therefore, at a low price. As a consequence, there might be an increasing number of closings for short-positions that would not be justified adopting an economic point of view and which would, therefore, merely be taken on the basis of undue capital management considerations. The recognition of options with their delta-equivalent - that is the equivalent value upon exercise of the option as well as the probability to exercise - is the only appropriate way of dealing with those instruments.

We, therefore, suggest applying the delta-equivalent to positions with the character of options, as for example defined in Articles 280 and 329 CRR. If there would be circumstances for which such treatment would not seem appropriate, EBA should refer to the definition of the Basel Committee which is reflected in Article 4, § 114 CRR: a bank needs to deduct the amount from its own funds which reflects the maximum loss which it could incur if the counterparty is insolvent.

For equity index products, regarding the netting of positions with a residual maturity lower than one year, we would like to recommend the use of buckets. Thus, we suggest allowing the netting between long and short positions of the same underlying exposure for each bucket (e.g. three months, six months and nine months).

**Q06: Are the provisions relating to the deduction of serial or parallel holdings through intermediate entities sufficiently clear? Do you see any unexpected consequences? Are there issues which need to be elaborated further?**

Concerning Article 14c, the calculation for financing that includes tranches does not produce an appropriate outcome. In our view the reason for this is the missing recognition of seniority for individual exposures. This leads to a non-risk-adequate recognition in contrast to the application of the securitisation framework.

For these deductions, we would also like to strongly suggest the EBA to include examples in the annex of the final RTS.

**Q07: Are the provisions of Article 14d relating to a structure-based approach sufficiently clear? Are there issues which need to be elaborated further?**

- We strongly insist that the final version of the RTS would include examples illustrating how the structure-based approach would work.



- It should be clarified that the positions that have been looked-through via structure-based approach should be recognised not only as a significant holding position with risk weighting of 250% but also within the 10%-/15%-threshold for significant holdings. The treatment of opaque positions as a 100%-investment and therefore the application of a full deduction approach seems unreasonable.
- To make the calculation of indirect holdings referred to in Article 14b less burdensome from an operational point of view, there would be a merit in differentiating between exposures in intermediate entities
  - (i) Concerning exposures to intermediate entities that are sufficiently granular, institutions should be authorised to calculate risk weighted assets (applying a 250% weighting) instead being obliged to deduct them from their own funds.
  - (ii) Concerning non-granular exposures to intermediate entities, the approach described under Q3 above should apply.

Granular exposures to intermediate entities should be defined as exposures where its largest underlying is below 5 % of the total transaction (analogue to granularity threshold applied for Large Exposures Requirements).

### **Further remarks on deductions**

The requirements for classifying entities as “significant” seem vague and partly inappropriate.

On the one hand it is unclear if “gross long direct positions” have to be considered together with net or gross “indirect and synthetic positions”. On the other hand the RTS appears to have a different focus than the underlying requirements of CRR. According to CRR, a significant holding is existing if (Art. 43) “the institution *owns* more than 10 % of the Common Equity Tier 1 instruments issued by that entity” which pleads for the focus on direct investments. This would also be more consistent in comparison to the other two cases mentioned in Art. 43 CRR that focus on a close link and/or inclusion in the same group (accounting consolidation). The concept of the CRR is obviously rather focused on a corporate law and capital-orientated relationship, that is on investments calculated on a direct and gross basis. We therefore believe a definition to be more adequate that only refers to positions that lead to such a relationship. We believe that this definition would include all direct holdings.

We would like to point out that a different concept taking into account all net positions would not only lead to a discrepancy with the other 2 cases mentioned in Art. 43 CRR. It also would lead to a virtually insolvable operational and calculation problem. This results from the fact that the calculation of gross as well as net positions would be based on book values (direct and most indirect positions) and notionals (synthetic positions). For the calculation of the CET1 investment ratio they would have to be compared with the CET1 of the financial sector entity, which could be calculated based on the other entities balance sheet, pillar 3 report, if available, or publicly available information on number of shares or subscribed capital. Almost certainly this will lead to misleading results, that don't make sense from an economic perspective. A concept based on direct positions would allow to concentrate on some special cases that could be calculated with way more accuracy.

**Q9: What in your view is the best means for ensuring that the benchmark rate is not materially affected by the credit standing of an individual participating institution? The criterion of minimum number of contributors or that of minimum representativeness of the market or both?**

Concerning benchmarks, the representativeness of the participating institutions appears to be more relevant than the sheer number of parties involved, i.e. the number of participants is of secondary importance.

**Q10: What would be the minimum number of contributors to ensure this absence of correlation? If a minimum representativeness of the market was chosen as an alternative route, how to ensure and calculate this representativeness? Would the percentage of 60% be sufficient?**

We do not support setting fixed minimum percentages. As markets can be very different, the required and realised representativeness should be assessed on a case-by-case basis.

**Q11: How would you treat minority interests arising from an institution permitted, under Article [9] of the CRR, to incorporate a subsidiary in the calculation of its solo requirement (individual consolidation method)?**

The suggested requirement to perform two calculations is burdensome. Irrespective of the outcome of these calculations, a bank will only be allowed to report the lowest eligible minority interest. It does not seem logical to provide a choice of two calculations if the most conservative outcome is always to be used. From that perspective, the sub-consolidation should apply.

In case of a combination of subsidiary A (sub-consolidated) of B [that is a subsidiary of M] & A (solo consolidated) we would first apply solo consolidation and then sub-consolidation. If EBA desires to keep both calculations, a bank should be allowed to choose one and deduct the amount that results from the chosen calculation.

**Q12: How would you treat minority interests arising from a subsidiary not subject to supervision on a sub-consolidated basis although it is the parent undertaking of other institutions? If the subsidiary would be allowed to undertake the calculation referred to in Article 79(1) on the basis of its sub-consolidated situation, some conditions would have to apply in order to secure this calculation in the absence of supervision on a sub-consolidated basis. What would you propose as conditions?**

Such sub-consolidation (regulatory or not) should be permitted where there are minority interests arising from a parent undertaking of regulated financial institution.

First, there is the case when the subsidiary is only subject to individual capital requirements, we think that in those cases a hypothetical sub-consolidation could serve for excess capital calculation purposes.

In the case of subsidiaries that are parents in a third country and are not subject to capital requirements ratio we consider that the CRR would allow the recognition of the minority interest when the subsidiary is subject to requirements that result in “de facto” minimum capital requirements equivalent to those



resulting of the sub-consolidation (article 81.a.ii). This is the case when the subsidiary is not subject to minimum requirements but is required by law to be funded through common equity with no possibility to leverage through external funding nor from other companies of the same group, and whose only activity is to hold the stakes in the subsidiaries (no other intragroup operations are allowed).

In summary, we understand that if the subsidiary in question is not a regulated entity the calculation would be undertaken by looking at the immediate higher regulated parent entity level. In addition, we would emphasize the need that article 84 be interpreted as recognizing local prudential requirements when these are higher than the requirements at consolidated level. We think that article 84 should be read as that the only difference in the calculation between (i) and (ii) is the elimination of intragroup positions but the minimum ratio to apply should be the higher between the consolidated and the local.

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