EBA Consultation Paper

on

Draft Regulatory Technical Standards

on

Own Funds – Part one

(EBA/CP/2012/02)

London, 4 April 2012

Contents

I. Responding to this Consultation

The EBA invites comments on proposals put forward in this paper and in particular on the specific questions summarised in V.b.

Comments are most helpful if they:

- respond to the question stated;
- indicate the specific question/Article to which the comment relates;
- contain a clear rationale;
- provide evidence to support the views expressed/ rationale proposed; and
- describe any alternative regulatory choices EBA should consider.

Please send your comments to the EBA by email to CP-2012-02@eba.europa.eu by 4 July 2012, indicating the reference 'EBA/CP/2012/02'. Please note that comments submitted after the deadline, or sent to another e-mail address will not be processed. Answers should be sent preferably both in PDF and Word formats.

Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. Please indicate clearly and prominently in your submission any part you do not wish to be publicly disclosed. A standard confidentiality statement in an e-mail message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with the EBA's rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the EBA's Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.eba.europa.eu under the heading 'Copyright and Disclaimer'.

II. Executive Summary

The CRR/CRD IV proposals[1] (the so-called Capital Requirements Regulation - henceforth 'CRR'- and the so-called Capital Requirements Directive – henceforth 'CRD') set out prudential requirements for Own Funds which are expected to be applicable as of 1 January 2013.

In a number of Articles, the CRR contains specific mandates for the EBA to develop draft Regulatory Technical Standards (henceforth 'RTS') related to Own Funds.

These RTS will be part of the single rulebook enhancing regulatory harmonisation in Europe with the particular aim of strengthening the quality of capital.

Please note that the EBA has developed draft RTS based on the proposed legislative texts for the CRR/CRD IV. To the extent that the text will change before the adoption, EBA will adapt its draft RTS accordingly to reflect any developments.

Main features of the RTS

This consultation paper puts forward draft RTS related to the following Articles of the CRR related to Own Funds:

- Article 24(3);
- Article 25(2) point b);
- Article 26(3);
- Article 27(6);
- Article 33(2);
- Article 38(2);
- Article 46(5);
- Article 49(2);
- Article 71(3);

[1] Proposal for a Regulation of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms', published on 20th July 2011

- Article 73(3);
- Article 74(2);
- Article 78(2);
- Article 461(4);
- Article 465(3).

Separate consultations will cover draft technical standards related to the following Articles:

- Article 25(2) point a)
- Article 29(2);
- Article 31(2);
- Article 46(4);
- Article 84(4);
- Article 92(4);
- Article 424(2).

This consultation groups several RTS on Own Funds together for consistency reasons. All the RTS included in this consultation have to be submitted to the EU Commission by 1 January 2013. They cover in particular the following areas:

- Common Equity Tier 1 capital, in particular foreseeable charges or dividends, features of capital instruments of mutuals, cooperative societies or similar institutions, applicable forms and nature of indirect funding of capital instruments, limitations on redemption of own funds instruments;

- Additional Tier 1 capital, in particular the form and nature of incentives to redeem, the conversion or write-down of the principal amount, the use of special purpose entities;

- deductions from Common Equity Tier 1 capital and from own funds in general including deductions of capital instruments of financial institutions and insurance/reinsurance undertakings, losses of the current financial year, deferred tax assets, defined benefits pension fund assets, foreseeable tax charges;

- general requirements like indirect holdings arising from index holdings, supervisory consent for reducing own funds;

- transitional provisions for own funds in terms of grandfathering.

Separate consultations on the remaining RTS on Own Funds will follow. Their format and content will be determined according to the nature of the specific topics, or to whether EBA has to develop the RTS alone or with the other Authorities etc.

In order to facilitate the understanding of the text, the structure of the draft RTS follows the structure of the CRR, in particular with regard to Part Two of the CRR (Own Funds). Furthermore, each article of the CRR to which the draft RTS is related is cited in the text of the relevant articles and quoted in the text boxes that have been included for consultation purposes. In some cases, these boxes also contain questions for the consultation process. The numbering of the articles in the draft RTS is only indicative and may change in the final RTS depending on the final CRR text which may delete or add RTS related to own funds.

Some of the requirements apply to more than one type of capital instruments (Common Equity Tier 1 instruments, Additional Tier 1 instruments, or Tier 2 instruments). This is the case in particular for indirect funding of the purchase of an institution's capital instruments, for the nature of distributable items or incentives to redeem, and for the use of special purposes entities for indirect issuance of own funds instruments. As a consequence, these requirements have only been included once in the text, while relevant references have been made to the corresponding articles of the CRR.

III. Background and rationale

Draft RTS on Own funds

The so-called Omnibus Directive[2] amended the directives that are collectively known as Capital Requirements Directive (CRD)[3] in a number of ways, one of which was by establishing areas where the EBA is mandated to develop draft technical standards.

On July 20th 2011, the European Commission issued its legislative proposals on a revision of the CRD which seeks to apply the Basel III framework in the EU. These proposals have recast the contents of the CRD into a revised CRD and a new CRR - which are colloquially referred to as the CRR/CRD IV proposals. These are currently being debated by the EU legislators (Council and European Parliament) in the framework of the co-decision procedure.

In anticipation of the finalisation of the legislative texts for the CRR/CRD IV, the EBA has developed the draft RTS in accordance with the mandate contained in different articles of the CRR (see Executive Summary for the detailed list of articles of the CRR) on the basis of the European Commission's proposals.

EBA will adapt the draft RTS according to the final version of the CRR/CRDIV text before submitting them to the European Commission for adoption.

The nature of RTS under EU law

These draft RTS are produced in accordance with Article 10 of EBA regulation[4]. According to Article 10(4) of EBA regulation, they shall be adopted by means of regulations or decisions.

According to EU law, EU regulations are binding in their entirety and directly applicable in all Member States. This means that, on the date of their entry into

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[2] Directive 2010/78/EU of the European Parliament and of the Council of 24 November 2010 amending Directives 98/26/EC, 2002/87/EC, 2003/6/EC, 2003/41/EC, 2003/71/EC, 2004/39/EC, 2004/109/EC, 2005/60/EC, 2006/48/EC, 2006/49/EC and 2009/65/EC in respect of the powers of the European Supervisory Authority (European Banking Authority), the European Supervisory Authority (European Insurance and Occupational Pensions Authority) and the European Supervisory Authority (European Securities and Markets Authority)

[3] Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions and Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions.

[4] Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC.

force, they become part of the national law of the Member States and that their implementation into national law is not only unnecessary but also prohibited by EU law, except in so far as this is expressly required by them.

Shaping these rules in the form of a Regulation would ensure a level-playing field by preventing diverging national requirements and would ease the cross-border provision of services since each time an institution wishes to take up operations in another Member State it currently has to assess a different set of rules.

Background and regulatory approach followed in the draft RTS

The current applicable regulatory framework in terms of own funds is derived from the CRD, in particular Articles 56 to 67, as transposed by each Member State. The CRD has been complemented by the publication of two sets of guidelines from the Committee of European Banking Supervisors (CEBS), the predecessor of the EBA. The first set of guidelines, published in December 2009, relates to hybrid capital instruments[5]. The second set of guidelines, published in June 2010, refers to elements of Article 57(a) of the CRD[6].

In December 2010, the Basel Committee on Banking Supervision (BCBS) published its "global regulatory framework for more resilient banks and banking systems" aiming at addressing the lessons from the financial crisis. The CRR proposals related to own funds translate the BCBS proposals into EU law. Both reforms raise both the quality and quantity of the regulatory capital base. The draft RTS as put forward by the EBA for this consultation derive directly from the CRR proposals which are expected to be applicable as of 1 January 2013.

The proposed draft RTS elaborate on the different elements of own funds: Common Equity Tier 1 capital, Additional Tier 1 capital, Tier 2 capital, deductions from these different types of capital, transitional arrangements for own funds as put forward by the CRR. Where deemed appropriate, EBA built on former CEBS guidelines on hybrids and core capital to draft some aspects of the RTS, for example in terms of supervisory consent for reducing own funds or for some provisions related to mutuals, cooperative societies or similar institutions.

The requirements contained in the draft RTS are mainly directed at institutions, although some of them are directed at competent authorities.

[5] http://www.eba.europa.eu/CMSPages/GetFile.aspx?nodeguid=97f3cd8f-855c-40de-a98b-b923e8eaa4ad

[6] http://www.eba.europa.eu/documents/Publications/Standards---Guidelines/2010/Guidelines_article57a/Guidelines_article57a.aspx

IV. Draft Regulatory Technical Standards on Own Funds

Preceding the text of certain of the draft RTS are further explanations on specific aspects of the proposed text occasionally provided, which either offer examples or provide the rationale behind the provision, or set out specific questions for the consultation process. Where this is the case, the explanatory text appears in a framed text box.

The final numbering of the articles, as well as the Titles, Chapters and Sections might change after the adoption of the CRR and the finalization of the consultation of this RTS and the remaining RTS.

EUROPEAN COMMISSION

Brussels, XXX
[…](2012) XXX draft

COMMISSION DELEGATED REGULATION (EU) No …/..

of XXX

on […]

Own Funds requirements for institutions

according to the European Parliament and the Council Regulation (EU) No [CRR number]

COMMISSION DELEGATED REGULATION (EU) No …/..

supplementing Regulation xx/XX/EU of the European Parliament and of the Council [CRR number] with regard to regulatory technical standards for Own Funds

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to [Regulation (..) No xx/xxxx] of the European Parliament and of the Council of dd mmmm yyyy on ….[7] [CRR number], and in particular Articles 24(3), 25(2), 26(3), 27(6), 29(2), 31(2), 33(2), 38(2), 46(5), 49(2), 71(3), 73(3), 74(2), 78(2), 84(4), 92(4), 461(4), 465(3) thereof

Whereas:

(1) Regulation (..._) No xx/xxx ('CRR') provides, in Part Two, Title II, rules on the elements of own funds of institutions and in Part Ten, Section 5, rules on deductions from these same elements of own funds during the transitional period of the application of the CRR. Both of these sections of the CRR provide empowerments to the European Commission to adopt delegated acts (regulatory technical standards) in accordance with articles 10-14 of the Regulation (EU) No 1093/2010 establishing the European Banking Authority ('EBA'). These acts will complete the EU single rulebook for institutions in the area of own funds and it is therefore useful that they are grouped together in one legal act to facilitate a comprehensive view, improved understanding and compact access to them by legal or natural persons subject to the obligations laid down herein.

(2) It is necessary to bring more convergence in the way foreseeable dividends have to be deducted from interim or year-end profits with the introduction of a hierarchy to evaluate the deduction: in the first place decision on distributions from the relevant body, second, the dividend policy, and third an historical payout ratio.

(3) It is desirable to define situations which would qualify as indirect funding, applicable to all types of capital instruments.

(4) Rules on own funds need to be specified when applied to the European cooperative banking sector (mutuals, cooperative societies or similar institutions) whose specificities have to be taken into account in an appropriate manner. This requires, among others, a specification of: the characteristics of the instruments that could weaken the condition of an institution in periods of market stress; the limitations that the institution

[7] OJ…….

should be able to apply to the redemption of these instruments. Where, regarding instruments of mutuals, cooperative societies or similar institutions, the refusal by the institution of the redemption of instruments is prohibited under applicable national law, it is appropriate that the provisions governing the instruments give the institution the ability to defer their redemption and limit the amount to be redeemed. It is appropriate for competent authorities to have the power to limit the redemption of cooperative shares and for institutions to document any decision to limit the redemption.

(5) It is important to ensure that there is a uniform approach concerning the deduction from own funds of certain items like losses for the current financial year, deferred tax assets that rely on future profitability, and defined benefit pension fund assets.

(6) It is necessary to ensure that, where exemptions from and alternatives to deduction are provided, sufficiently prudent requirements are applied. In order for cooperative networks to benefit from a waiver on the deduction of holdings in other entities of the network, institutions included in each institutional protection scheme should meet the capital requirements on a consolidated basis.

(7) There is a need for consistency in the way incentives to redeem are assessed. It is therefore necessary to provide a description of cases where an expectation is created that the instrument is likely to be redeemed. There is also a need to design rules leading to timely activation of loss absorbency mechanisms for hybrid instruments and consequently increasing the loss absorbency of these instruments in the future. Further, the use of special purpose entities for indirect issuance of own funds has to be restricted and strictly framed.

(8) It is necessary to balance the need between ensuring prudentially appropriate calculations of exposures of institutions to indirect holdings arising from index holdings, with the need to ensure this does not become overly burdensome for them, i.e. when these positions are not material.

(9) A detailed and comprehensive process is deemed necessary for competent authorities to grant a supervisory consent for reducing own funds. Redemptions, reductions and repurchases of own funds instruments should not be announced to holders before the institution has obtained the prior approval of the relevant competent authority. Institutions should provide a detailed list of information in order for the competent authority to grant its approval.

(10) Temporary waivers for deduction from own funds should not exceed the duration of the financial assistance operation plan.

(11) Given that instruments issued by special purpose entities give less certainty in prudential terms than directly issued instruments, in order for them to qualify for inclusion under the Additional Tier 1 and Tier 2 own funds items, the assets of the special purpose entities not invested in own funds instruments issued by institutions should remain minimal and insignificant.

(12) It is important, when applying the transitional provisions for filters and deductions, that the treatment applied is consistent with the national rules transposing Directives 2006/48/EC and 2006/49/EC.

(13) Excess grandfathered Common Equity Tier 1 or Additional Tier 1 instruments could be included within the grandfathering buckets for lower tiers of capital. Any inclusion in the lower bucket is only possible if there is sufficient headroom to accommodate the additional recognition in that bucket. Finally, it should be possible for instruments to be subject to upwards reclassification.

(14) It is necessary that the new regime for elements of own funds for institutions enters into force the soonest possible following the entry into force of the CRR, given the European Commission's political commitment to that effect, both within Europe and internationally.

(15) This Regulation is based on the draft regulatory technical standards submitted by the European Supervisory Authority (European Banking Authority - EBA) to the Commission.

(16) The European Supervisory Authority (European Banking Authority - EBA) has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits, in accordance with Article 10 of Regulation (EU) No 1093/2010, and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010,

HAS ADOPTED THIS REGULATION:

TITLE I

Subject matter and definitions

Article 1

Subject matter

This Regulation lays down uniform rules concerning:

a) the meaning of foreseeable when determining whether foreseeable charges or dividends have been deducted from own funds according to Article 24 (3) CRR;
b) conditions according to which competent authorities may determine that a type of undertaking recognised under applicable national law qualifies as a mutual, cooperative society or similar institution, according to Article 25(2) CRR; [*to be added by separate consultation*]
c) the applicable forms and nature of indirect funding of capital instruments; and the meaning of distributable items for the purposes

of determining the amount available to be distributed to the holders of own funds instruments, according to Article 26(3) CRR;

d) the nature of limitations on redemption necessary where the refusal by the institution of the redemption of own funds instruments is prohibited under applicable national law, according to Article 27(6) CRR;
e) the concept of a gain on sale according to Article 29(2) CRR; [*to be added by separate consultation*]
f) the conditions for applying additional value adjustments when calculating the amount of own funds according to Article 31(2) CRR; [*to be added by separate consultation*]
g) the application of the deductions from Common Equity Tier 1 items and other deductions for Common Equity Tier 1, Additional Tier 1 and Tier 2 items according to Article 33(2) CRR;
h) the criteria according to which competent authorities shall permit institutions to reduce the amount of assets in the defined benefit pension fund, according to Article 38(2) CRR;
i) the conditions for exemption from, and alternatives to, deduction where consolidation is applied according to Article 46(5) CRR;
j) form and nature of incentives to redeem, nature of the write-down of the principal amount and procedures and timing surrounding trigger events, features of instruments that could hinder recapitalisation and use of special purpose entities, according to Article 49(2) CRR;
k) the extent of conservatism required in estimates used as an alternative to the calculation of underlying exposures for indirect holdings arising from index holdings, according to Article 71(3) CRR;
l) the detailed conditions that need to be met before a supervisory consent for reducing own funds can be given, and the relevant process, according to Article 73(3) CRR;
m) the conditions for a temporary waiver for deduction from own funds to be provided, according to Article 74(2) CRR;
n) the concepts of minimal and insignificant for the purposes of determining Qualifying Additional Tier 1 and Tier 2 capital issued by a special purpose entity according to Article 78(2) CRR;
o) the activities that are a direct extension of banking, or that concern services ancillary to banking or similar activities, for the purposes of risk weighting and prohibition of qualifying holdings outside the financial sector according to Article 84(4) CRR; [*to be added by separate consultation*]
p) the specification of some conditions for calculating own funds for investment firms based on fixed overheads , according to Article 92(4) CRR; [*to be added by separate consultation*]
q) the detailed conditions for adjustments to own funds under the transitional provisions, according to Article 461(4) CRR;

r) the conditions for items excluded from grandfathering in Common Equity Tier 1 or Additional Tier 1 items in other elements of own funds, according to Article 465(3) CRR.

Definitions of the CRR shall apply to this Regulation.

Explanatory text for consultation purposes Some RTS on own funds are not ready for consultation yet and will be consulted separately. This is in particular the case for the RTS based on the following articles of the CRR: 25(2) point a), 29(2), 31(2), 46(4), 84(4), 92(4). The ITS on disclosure by reference to article 424(2) of the CRR will also be consulted separately. 14 RTS are included in this consultation. The EBA has deemed useful for consistency reasons to group the RTS related to own funds in a single text rather than having separate stand-alone texts. This allows having a comprehensive view on the RTS related to own funds. The RTS which are not included in this consultation although subject to the same deadline (submission to the EU Commission by 1 January 2013) and the RTS included in this consultation may be grouped together at a final stage in a single text for Own Funds. In order to facilitate the reading and the link with the corresponding articles of the relevant legislative act, these RTS follow the structure of the relevant sections of the CRR.

TITLE II

Elements of Own Funds

Chapter 1

Common Equity Tier 1 capital

Section 2

Common Equity Tier 1 items and instruments

Article 2

Meaning of foreseeable charge or dividend under Article 24(2)(b) of the CRR

(Legal basis: art. 24(3) CRR)

Explanatory text for consultation purposes

According to Article 24(3) of the CRR, EBA shall develop draft regulatory technical standards to specify the meaning of foreseeable when determining whether any foreseeable charge or dividend has been deducted.

For the purpose of determining the amount of interim or year-end profits that may be included in Common Equity Tier 1 capital according to paragraph 2 of Article 24 of the CRR, the institution shall reduce the amount of those profits by the foreseeable charges and dividends. Any charges or dividends that are reasonably expected to be paid out of the interim or year-end profit in relation to the time period over which the profits are being assessed shall reduce the amount of profit that counts as eligible Common Equity Tier 1 items at the date of calculation of the Common Equity Tier 1 capital.

In the following draft RTS, the dividend policy relates to the general/usual dividend policy of the institution normally applicable. In cases where the management body has taken a decision regarding the dividends for the profits under consideration, this decision will serve as a basis for the deduction of foreseeable dividends.

Questions for consultation:

Q01. Are the provisions on the meaning of foreseeable when determining whether any foreseeable charge or dividend has been deducted sufficiently clear? Are there issues which need to be elaborated further? What would be your definition of foreseeable?

1. For the purpose of the reporting obligations according to Article 95 of the CRR, the amount of foreseeable dividends to be deducted by institutions from the interim or year-end profits as referred to in Article 24(2) of the CRR, shall be determined pursuant to paragraphs 2, 3 and 4.

2. Where the management body has formally taken a decision or proposed a decision to the relevant body on the amount of dividends to be distributed, this amount shall be deducted from the interim or year-end profits under consideration.

3. Before the management body has formally taken a decision or proposed a decision to the relevant body on the distribution of dividends, the amount of foreseeable dividends to be deducted by institutions from the interim or year-end profits equals the amount of interim or year-end profits multiplied by the dividend payout ratio.

4. The dividend payout ratio shall be determined on the basis of the dividend policy approved by the management body or other relevant body. In the absence of an approved dividend policy, or when, in the opinion of the competent authority, it is likely that the institution will not apply its dividend policy or this policy is not a prudent basis to determine the amount of deduction, the dividend payout ratio shall be based on the highest of the following:

   (a) the dividend payout ratio calculated as an average of the dividend payout ratios of the three years prior to the year under consideration;

   (b) the dividend payout ratio of the year preceding that of the year under consideration.

   The competent authority may authorise the institution to adjust the calculation of the dividend payout ratio as described in points (a) and (b) to exclude exceptional dividends paid during the period.

5. The amount of foreseeable dividends to be deducted shall be determined taking into account any regulatory restrictions on distributions, in particular restrictions determined in accordance with Article 131 of the CRD. The amount of profit subject to such restrictions may be included fully in Common Equity Tier 1 if the condition of point (a) of Article 24(2) of the CRR is met. When such restrictions are applicable, the foreseeable dividends to be deducted shall be based on the capital conservation plan agreed by the competent authority pursuant to Article 132 of the CRD.

6. The amount of foreseeable charges to be taken into account shall comprise taxes, and the amount of any obligations or circumstances arising during the related reporting period which are likely to reduce the profits of the institution and for which the competent authority is not satisfied that all necessary value adjustments, such as additional value adjustments according to Article 31 of the CRR, or provisions have been made.

7. The competent authority shall be satisfied that all necessary deductions to the interim or year-end profits and related to foreseeable charges have been made, either under applicable accounting rules or under any other adjustments, before consenting that the institution includes interim or year-end profits in Common Equity Tier 1 capital.

Article 3

Type of undertaking recognised under applicable national law as a mutual, cooperative institution or similar institution under Article 25(1)(a) of the CRR

(Legal basis: Article 25(2)(a) of the CRR)

Explanatory text for consultation purposes According to point (a) of Article 25(2) of the CRR, EBA shall develop draft regulatory technical standards to specify the conditions according to which competent authorities may determine that a type of undertaking recognised under applicable national law qualifies as a mutual, cooperative society or a similar institution. This RTS will be part of a second consultation.

Article 4

Capital instruments of mutuals, cooperative societies or similar institutions in Common Equity Tier 1 items under Article 25(1)(c) of the CRR

(Legal basis: 25(2)(b)(i) CRR)

According to point (b) of Article 25(2) of the CRR, EBA shall develop draft regulatory technical standards to specify the nature and extent of the following: (i) the features that could cause the condition of an institution to be weakened as a going concern during periods of market stress; (ii) the market stress under which such features could cause the condition of the institution to be weakened as a going concern. In the following draft RTS, it is clarified in particular that, by reference to Articles 27(4) and 27(5) of the CRR, the existence of a cap on the claim on the assets does not contradict the ability of the instrument to absorb the first and proportionately greatest share of losses as they occur, provided that the cap is applicable to all holders of all Common Equity Tier 1 instruments. The final RTS will be adapted to take into account the final adopted version of the CRR in which the provisions contained in Articles 26 and 27 may evolve.

1. Features that could cause the condition of an institution to be weakened as a going concern during periods of market stress shall comprise legal or contractual provisions that, in particular :

   (a) require the institution to make distributions to the holders of the instrument during periods of market stress.
   (b) imply that the instrument does not absorb the first and proportionately greatest share of losses as they occur and therefore that the instrument is not fully loss absorbent on a going concern basis.

2. Where an instrument includes a cap or indication on the maximum level of distributions, that instrument shall not fall under paragraph (1)(a) but it shall instead qualify as an Common Equity Tier 1 item, if all of the following conditions are met:

   (a) the instrument shall not contain an obligation to pay the determined amount at any time;
   (b) the instrument shall not be marketed in a way which suggests to investors that the distributions to holders will be paid;
   (c) distributions to holders shall not be fixed percentages or amounts.

3. Where a capital instrument entitles its owners to a right to the reserves in case of redemption, insolvency and liquidation, that is limited, in particular to the nominal value of the instrument, or subject to a cap, and the reserves absorb the first losses, that instrument shall not fall under paragraph (1)(b) but it shall instead be considered as fully loss absorbent, provided that this limitation applies to the same degree to all holders of all Common Equity Tier 1 instruments issued by the institution.

4. The instrument may not include legal or contractual provisions that could hinder the recapitalisation of the institution as referred to in Article 23 of this Regulation.

Article 5

Definition of Market Stress under Article 25(1)(c) of the CRR

(Legal basis: Article 25(2)(b)(ii) CRR)

Market stress shall be defined as any stress related to markets which has a material impact on the institution’s viability. In particular, market stress shall include circumstances that lead to the occurrence of substantial losses for the institution that significantly diminish its ability to access liquidity or capital in a sustainable manner.

Article 6

Applicable forms and nature of indirect funding of capital instruments under Article 26(1)(b) and 49(1)(c) of the CRR

(Legal basis: Article 26(3)(a) of the CRR) [and 49-To be added at L1 text]

Explanatory text for consultation purposes According to Article 26(3) of the CRR, EBA shall develop draft regulatory technical standards to specify the following: (i) the applicable forms and nature of indirect funding of capital instruments; (ii) (...) As a general principle, the RTS intend to be framework neutral in terms of accounting standards. Where the RTS make reference to IFRS Regulation, as in this Article and in Article 13, the reference intends to be in terms of substance, and not in terms of form, in order to refer to a common understanding. Questions for consultation: Q02. Are the provisions on the applicable forms of indirect funding of capital instruments sufficiently clear? Are there issues which need to be elaborated further? Q03. How do you assess the provisions on related parties in particular the requirement to assess that, on an on going basis, the related party has sufficient revenues?

1. Direct funding means situations where an institution has granted a loan or other funding in any form to an investor for the purpose of the purchase of its capital instruments. The applicable forms and nature of indirect funding of the purchase of an institution’s capital instruments shall include the following:

   (a) funding of an investor’s purchase, at issuance or thereafter, of an institution’s capital instruments by entities included in the scope of prudential consolidation of the institution or included in the scope of supplementary supervision of the institution in accordance with Directive 2002/87/EC on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate;

   (b) funding of an investor’s purchase, at issuance or thereafter, of an institution’s capital instruments by external entities that are protected by a guarantee or by the use of a credit derivative or are secured in some other way so that the credit risk is transferred to the institution or to any entities included in the scope of prudential consolidation of the institution or included in the scope of supplementary supervision of the institution in accordance with Directive 2002/87/EC;

(c) funding of a borrower that passes the funding on to the ultimate investor for the purchase, at issuance or thereafter, of an institution's capital instruments;

(d) funding, for other purposes than purchasing an institution's capital instruments, of any natural or legal person who has a qualifying holding in the credit institution, as referred to in Article 4(21) of the CRR, or who is deemed to be a related party within the meaning of the definitions in paragraph 9 of International Accounting Standard 24 on Related Party Disclosures as applied in the EU according to Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards [8], taking into account any additional guidance as defined by the competent authority, if the institution is not able to demonstrate the following:

(i) the transaction is realized at similar conditions than other transactions with third parties;

(iii) the natural or legal person or the related party has sufficient revenues on an ongoing basis, other than the distributions on the capital instruments held, to support the payment of interest and repayment of the funding.

2. In order for the above cases to be considered as indirect funding, where applicable, the following conditions shall also be met:

(a) The investor is not included in the scope of prudential consolidation of the institution or in the scope of the supplementary supervision of the institution in accordance with Directive 2002/87/EC;

(b) the external entity is not included either in the scope of prudential consolidation of the institution or in the scope of the supplementary supervision of the institution in accordance with Directive 2002/87/EC.

3. Where direct or indirect funding of the purchase of a capital instrument has been individually assessed for impairment and an impairment allowance

[8] OJ L 243, 11.9.2002, p. 1.

has been made, the amount to be excluded from own funds of the institution shall be net of the impairment allowance.

4. With regard to mutuals, cooperative societies and similar institutions, where there is an obligation under national law or the statutes of the institution for a customer to subscribe capital instruments in order to receive a loan, that loan is not considered as a direct or indirect funding under the conditions that:

   (a) the amount of the subscription in not material;
   (b) the purpose of the loan is not the purchase of an institution's capital instrument;
   (c) the subscription of the institution's capital instrument is necessary in order for the beneficiary of the loan to become a member of the mutual, cooperative society or similar institution.

Article 7

Distributable items under Articles 26(1)(h)(ii) [and 49(1)(l)(i) of the CRR]

(Legal basis Article 26(3) of the CRR) *[and 49-To be added at L1 text]*

Explanatory text for consultation purposes According to point (b) of Article 26(3) of the CRR, EBA shall develop draft regulatory technical standards to specify the following: (iii) (...) (iv) the meaning of distributable items for the purposes of determining the amount available to be distributed to the holders of own funds instruments of an institution. The final RTS will be adapted to take into account the final adopted version of the CRR in which the definition of distributable items for Additional Tier 1 instruments is likely to evolve.

For the purpose of points (h) (ii) of Article 26(1) and points (l) (i) of Article 49(1), the distributable items shall mean the amount that is available for distribution to holders of own funds instruments as defined pursuant to the applicable national laws and the statutes of the institution.

Except where otherwise stated in the applicable national laws and the statutes of the institution, distributable items mean the amount of the profits at the end of the last financial year plus any profits brought forward and reserves available for this purpose before distributions to holders of own funds instruments, less any losses brought forward and sums placed to non distributable reserves in accordance with applicable national law or the statutes. They shall be determined on the basis of the individual accounts of the institution and not on the basis of the consolidated accounts. They shall take into account any regulatory restrictions on distributions, in particular restrictions pursuant to Article 131 of the CRD.

Article 8

Limitations on redemption of own funds instruments issued by mutuals, cooperative societies and similar institutions under Article 27(2)(b) of the CRR [and Article 73(2) of the CRR]

(Legal basis: Articles 27(6) of the CRR) [and 73(3)(b) of the CRR]

Explanatory text for consultation purposes

According to Article 27(6) of the CRR, EBA shall develop draft regulatory technical standards to specify the nature of the limitations on redemption necessary where the refusal by the institution of the redemption of own funds instruments is prohibited under applicable national law.

For the purpose of this RTS, a reference is made in point (b) of paragraph 2 to the minimum requirements, the specific own funds requirements and the combined buffer. The finalisation of the RTS will be adapted to take into account where appropriate the implementation of an additional buffer for systemic institutions.

Questions for consultation:

Q04. Are the provisions on the limitations on redemption of own funds instruments sufficiently clear? Are there issues which need to be elaborated further?

Q05. How would you assess the impact of documenting decisions on redemptions?

Q06. How would you assess the cost impact of including in the provisions of the instruments criteria as listed in paragraphs 2 and 3? *(please note that the CRR requires in point (b) of Article 27 (2) that where the refusal by the institution of the redemption of instruments is prohibited under applicable national law, the provisions governing the instruments shall give the institution the ability to limit their redemption).*

1. The ability of the institution to limit the redemption under the provisions governing the own funds instruments as referred to in point (b) of Article 27(2) and 73(2) of the CRR, shall encompass both the right to defer the redemption and the right to limit the amount to be redeemed. The institution shall be able to defer the redemption or limit the amount to be redeemed for an unlimited period of time pursuant to paragraph 2.

2. The extent of the limitations on redemption included in the provisions governing the instruments shall be determined on the basis of the prudential situation of the institution at any time, having regard to in particular, but not limited to:

   (a) the overall financial, liquidity and solvency situation of the institution;

   (b) the amount of Common Equity Tier 1 capital, Tier 1 and total capital compared to the total risk exposure amount calculated in accordance with the requirements laid down in point (a) of Article 87(1) of the CRR, the specific own funds requirements referred to in Article 100 of the CRD and the combined buffer referred to in Article 122(2) of the CRD.

3. The limitations on redemption included in the contractual or legal provisions governing the instruments shall not prevent the competent authority from limiting further the redemption on the instruments on an appropriate basis as foreseen by Article 73 of the CRR.

4. Competent authorities shall assess the bases of limitations on redemption included in the contractual and legal provisions governing the instrument. They shall require institutions to modify the corresponding contractual provisions if they are not satisfied that the bases of limitations are appropriate. In situations where the instruments are governed by the national law in the absence of contractual provisions, the legislation shall enable the institution to limit redemption as described in this Article in order for the instruments to qualify as Common Equity Tier 1.

5. Any decision to limit redemption shall be documented internally and in writing by the institution to the competent authority, including the reasons why, in view of the criteria set out in paragraph 2, a redemption has been partially or fully refused or deferred.

6. Where several decisions to limit redemption are taking place in the same period of time, institutions may document these decisions in a single set of documents.

Section 2

Prudential filters

Article 9

The concept of gain on sale under Article 29(1)(a) of the CRR

(Legal basis: Article 29(2) of the CRR)

Explanatory text for consultation purposes According to Article 29(2) of the CRR, EBA shall develop draft regulatory technical standards to specify further the concept of a gain on sale referred to in point (a) of paragraph 1. This RTS will be part of a separate consultation.

Article 10

Additional value adjustments under Article 31(1) of the CRR

(Legal basis: Article 31(2) of the CRR)

Explanatory text for consultation purposes According to Article 31(2) of the CRR, EBA shall develop draft regulatory technical standards to specify the conditions according to which the requirements of Article 100 referred shall be applied for the purposes of paragraph 1. This RTS will be part of a separate consultation.

Section 3

Deductions from Common Equity Tier 1 items

Explanatory text for consultation purposes According to Article 33(2) of the CRR, EBA shall develop draft regulatory technical standards to specify the following: a) in greater detail, the application of the deductions referred to in points (a), (c), (e) and (l) of paragraph 1; b) (...)

According to Article 38(2) of the CRR, EBA shall develop draft regulatory technical standards to specify the criteria according to which a competent authority shall permit an institution to reduce the amount of assets in the defined benefit pension fund as specified in point (b) of paragraph 1.

Questions for consultation:

Q07. Are the provisions on the deductions related to losses for the current financial year, deferred tax assets, defined pension fund assets and foreseeable tax charges sufficiently clear? Are there issues which need to be elaborated further?

Article 11

Deduction of losses for the current financial year under Article 33(1)(a) of the CRR [and Article 24(1)(c) of the CRR]

(Legal basis: Article 33(2)(a) of the CRR) [and Article 24 of the CRR]

1. Where losses for the current financial year are included in Common Equity Tier 1 items as a result of an interim or a year-end financial report, a deduction is not needed. For the purpose of this Article, the financial report means that the profit and losses have been determined after a closing of the interim or the annual accounts in accordance with the accounting standards to which the institution is subject under Regulation 2002/1606/EC on the application of international accounting standards and Directive 86/635/EEC on the annual accounts and consolidated accounts of banks and other financial institutions.

2. When discharging its reporting obligations according to Article 95 of the CRR during the year, and when the institution does not close its financial accounts at the end of each interim period, the institution shall determine its profit and loss accounts and deduct any resulting losses from Common Equity Tier 1 as they arise. Any resulting profit may be included only if the condition of point (a) of Article 24(2) of the CRR is met.

3. For the purpose of paragraph 2, income and expenses shall be determined under the same process and on the basis of the same accounting standards as the one followed for the year-end financial report. Income and expenses shall be prudently estimated and shall be assigned to the interim period in which they incurred so that each interim period bears a reasonable amount of the anticipated annual income and expenses. Material or non-recurrent events shall be considered in full and without delay in the interim period during which they arise.

4. Paragraphs 1, 2 and 3 apply in the same manner to gains and losses included in accumulated other comprehensive income.

Article 12

Deductions of deferred tax assets that rely on future profitability under Article 33(1)(c) of the CRR

(Legal basis: Article 33(2)(a) of the CRR)

1. The amount of deferred tax assets that rely on future profitability may be reduced by the amount of the associated deferred tax liabilities of the institution, provided that the conditions listed in points (a) and (b) of Article 35(3) of the CRR are met.

2. Associated deferred tax liabilities are limited to those that arise from the tax law of the same jurisdiction as the deferred tax assets.

3. The amount of associated deferred tax liabilities which are eligible for offsetting deferred tax assets that rely on future profitability is the difference between the amounts referred to in following points (a) and (b):

   (a) the amount of deferred tax liabilities as recognized under the applicable accounting standards;

   (b) the amount of associated deferred tax liabilities arising from intangible assets and from defined benefit pension fund assets.

4. The difference between the amounts referred to in points (a) an (b) of paragraph 3 shall be subject to the provisions laid down in Article 35(5) of the CRR.

Article 13

Deduction of defined benefit pension fund assets under Article 33(1)(e) of the CRR [and Article 38(1)(b) of the CRR]

(Legal basis: Article 33(2)(a) of the CRR) [and Article 38(2) of the CRR]

The competent authority shall only grant the prior consent mentioned in point (b) of Article 38(1) of the CRR where the unrestricted ability to use the assets entails immediate and unfettered access to the assets, such as when the use of the assets is not barred by a restriction of any kind and there are no claims of any kind from third parties on these assets.

Article 14

Deductions of foreseeable tax charges under Article 33(1)(l) of the CRR

(Legal basis: Article 33(2)(a) of the CRR)

1. On the condition that the institution applies accounting standards and policies that provide for the full recognition of current and deferred tax effects related to transactions and other events recognized in the balance sheet or the profit and loss account, the institution may consider that foreseeable tax charges have been already taken into account.

2. Where the institution draws up its prudential reporting required by Article 95 of the CRR and in accordance with Regulation 2002/1606/EC on the application of international accounting standards, the condition of paragraph 1 is deemed to be fulfilled.

3. The competent authority shall be satisfied that all necessary deductions have been made, either under applicable accounting rules or under any other adjustments.

4. When the condition of paragraph 1 is not fulfilled, the institution shall adjust its Common Equity Tier 1 by the estimated amount of current and deferred tax charges not yet recognized in the balance sheet and profit and loss account related to transactions and other events recognized in the balance sheet or the profit and loss account. The estimated amount of current and deferred tax charges shall be determined using an approach equivalent to the one provided by Regulation 2002/1606/EC. The estimated amount of deferred tax charges may not be netted against deferred tax assets that are not recognized in the financial statements.

Section 4

Other deductions for Common Equity Tier 1, additional Tier 1 and Tier 2 items

Explanatory text for consultation purposes

According to Article 33(2) of the CRR, EBA shall develop draft regulatory technical standards to specify the following:

a) (...)
b) the types of capital instrument of financial institutions, third country insurance and reinsurance undertakings, and undertakings excluded from the scope of Directive 2009/138/EC in accordance with Article 4 of that Directive that shall be deducted from the following elements of own funds:

(i) Common Equity Tier 1 items
(ii) Additional Tier 1 items;
(iii) Tier 2 items.

Questions for consultation:

Q08. Are the provisions on the types of capital instruments of financial institutions, third country insurance and reinsurance undertakings, and undertakings excluded from the scope of Directive 2009/138/EC in accordance with Article 4 of that Directive that shall be deducted from the following elements of own funds sufficiently clear? Are there issues which need to be elaborated further?

Q09. How would you assess the impact of operating a deduction from Common Equity Tier 1 items?

Article 15

Other deductions for capital instruments of financial institutions under Article 33(2)(b) of the CRR

(Legal basis: 33(2) of the CRR)

1. Holdings of capital instruments of financial institutions as defined in Article 4(3) of the CRR shall be deducted from Common Equity Tier 1 items.

2. Those capital instruments shall specifically include the following:

   (a) all instruments qualifying as capital under the company law applicable to the issuer;

   (b) any dated and undated subordinated instruments;

   (c) for financial institutions that are subject to prudential solvency requirements, any other instruments included in the financial institution's own funds pursuant to the relevant applicable prudential framework.

3. The deduction from Common Equity Tier 1 items referred to in paragraph 1 shall not apply in the following cases:

   (a) the financial institution is authorized and supervised by a competent authority and subject to prudential requirements equivalent to those applied to institutions under the CRR. This approach shall be applied to third country financial institutions only where a coordinated equivalence assessment of the prudential regime of the third country concerned has been performed and where it has been concluded that it is, at least, equivalent to that applied in the Union.

(b) the financial institution is an electronic money institution within the meaning of Article 2 of Directive 2009/110/EC on the taking up, pursuit and prudential supervision of the business of electronic money institutions[9] and does not benefit from optional exemptions as provided by Article 9 of that Directive;

(c) the financial institution is a payment institution within the meaning of Article 4 of Directive 2007/64/EC on payment services in the internal market[10] and does not benefit from a waiver as provided by Article 26 of that Directive;

(d) the financial institution is an alternative investment fund manager within the meaning of Article 4 of Directive 2011/61/EU on Alternative Investments Fund Managers[11] or a management company within the meaning of Article 2(1) of Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS)[12].

4. In the cases foreseen in paragraph 3 of this Article, institutions shall apply the deductions as foreseen by the CRR for holdings of capital instruments based on a corresponding deduction approach. This means the deduction shall be applied to the same component of capital for which the capital would qualify if it was issued by the institution itself.

Article 16

Capital instruments of third country insurance and reinsurance undertakings under Article 33(2)(b) of the CRR

(Legal basis: Article 33(2) of the CRR)

1. Holdings of capital instruments of third country insurance and reinsurance undertakings that are subject to a prudential regime that either has been assessed by the European Insurance and Occupational Pensions Authority (hereafter EIOPA) as non-equivalent to the one provided by Directive 2009/138/EC on the taking-up and pursuit of the

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[9] OJ L 267, 10.10.2009, p. 7.
[10] OJ L 319, 5.12.2007, p. 1.
[11] OJ L 174, 1.7.2011, p. 1.
[12] OJ L 302, 17.11.2009, p. 32.

business of Insurance and Reinsurance[13] (Solvency II) (recast), or that has not been assessed by EIOPA, shall be deducted from Common Equity Tier 1 items.

2. Those capital instruments shall specifically include the following:

   (a) all instruments qualifying as capital under the company law applicable to the issuer;

   (b) any dated and undated subordinated instruments;

   (c) for third country insurance and reinsurance undertakings that are subject to prudential solvency requirements, any other instruments included in the third country insurance and reinsurance undertakings' own funds pursuant to the relevant applicable prudential framework.

3. Where deductions are deductions of holdings of capital instruments of third country insurance and reinsurance undertakings whose prudential regime, including rules on own funds, has been assessed by EIOPA as equivalent to the prudential regime provided by Directive 2009/138/EC, items shall be treated as holdings of undertakings included in the scope of Directive 2009/138/EC.

4. In the cases foreseen in paragraph 3 of this Article, institutions shall apply the deductions as foreseen by point (b) of Article 41, point (b) or Article 55 and point (b) of Article 65 of the CRR for holdings of own funds insurance items.

Article 17

Capital instruments of undertakings excluded from the scope of Directive 2009/138/EC under Article 33(2)(b) of the CRR

(Legal basis: Article 33(2) of the CRR)

1. Holdings of capital instruments of undertakings excluded from the scope of Directive 2009/138/EC in accordance with Article 4 of that Directive shall be deducted from Common Equity Tier 1 items.

2. Those capital instruments shall specifically include the following:

   (a) all instruments qualifying as capital under the company law applicable to the issuer;

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[13] OJ L 335, 17.12.2009, p. 1.

(b) any dated and undated subordinated instruments;

(c) any other instruments included in the undertaking's own funds pursuant to the relevant applicable prudential framework.

3. That deduction shall not apply where these undertakings are subject, under national law, to provisions equivalent to provisions applicable to undertakings included in the scope of Directive 2009/138/EC. In such a case, capital instruments shall be treated as holdings of undertakings included in the scope of Directive 2009/138/EC.

Section 5

Exemption from, and alternatives to, deduction where consolidation is applied

Explanatory text for consultation purposes According to Article 46(4) of the CRR, EBA, EIOPA and ESMA shall, through the Joint Committee, develop draft regulatory technical standards to specify for the purposes of this Article the conditions of application of the calculation methods listed in Annex I, Part II and Article 228(1) of Directive 2002/87/EC for the purposes of the alternatives to deduction referred to in paragraph 1 and point (a) of paragraph 3. This RTS will be part of a separate consultation and will probably be kept as a separate RTS.

Article 18

Exemption from, and alternatives to, deduction where consolidation is applied under Article 46(3)(b) of the CRR

(Legal basis: Article 46(5) of the CRR)

According to Article 46(5) of the CRR, EBA shall develop draft regulatory technical standards to specify the conditions of application of point (b) of paragraph 3. The EBA will also monitor the development of the CRR text related to this point, which is expected to change.

Q10. Are the provisions related to the requirements for cooperative networks sufficiently clear?

The following conditions shall apply:

(a) the rules on prudential consolidation foreseen by the CRR shall apply hereby as well.

(b) the consolidated report referred to in Article 108(7) of the CRR shall encompass all members of a same institutional protection scheme as well as their subsidiaries and their holdings in relevant entities. To determine if a relevant entity meets the definition of a subsidiary, the holdings of all the members and their own subsidiaries shall be considered together.

(c) the entities included in the consolidated report referred to in point (a) shall meet on a consolidated basis the minimum capital requirements laid down in Article 87 of the CRR. The consolidated capital ratios are reported according to Article 95 of the CRR.

(d) for the purpose of points (a) and (b), point (g) of Article 108(7) shall also apply.

(e) for the purpose of point (b), an institution's holdings in relevant entities which are part of the consolidated report referred to in paragraph (a), whereas the institution itself is not part of this consolidated report, shall be deducted from the institution's own funds in the manner prescribed in Articles 33, 53 and 63 of the CRR.

(f) for the purpose of point (b), all capital instruments held by entities which are part of the consolidated report referred to in point (a), in other relevant entities which are not part of the consolidated report, shall be deducted from the consolidated own funds in accordance with Articles 33, 53 and 63 of the CRR.

(g) where several institutional protection schemes exist in the same cooperative network, the conditions laid down in this Article shall apply to each of the institutional protection schemes and to all institutional protection schemes considered all together.

Chapter 2

Additional Tier 1 capital

Explanatory text for consultation purposes

According to Article 49(2) of the CRR, EBA shall develop draft regulatory technical standards to specify all the following:

(a) the form and nature of incentives to redeem;

(b) the nature of the write down of the principal amount;

(c) the procedures and timing for the following:

(i) determining that a trigger event has occurred;

(ii) notifying the competent authority and the holders of the instrument that a trigger event has occurred and that the principal amount of the instrument will be written down or the instrument converted to a Common Equity Tier 1 instrument, as applicable, in accordance with the provisions governing the instrument;

(iii) writing down the principal amount of the instrument, or converting it to a Common Equity Tier 1 instrument, as applicable;

(d) features of instruments that could hinder the recapitalisation of the institution;

(e) the use of special purposes entities for indirect issuance of own funds instruments.

Section 1

Form and nature of incentives to redeem

Questions for consultation:

Q11. Would you agree on the types of incentives to redeem as described in paragraph 2? Should other types of situations be considered as incentives to redeem?

Article 19

Form and nature of incentives to redeem under Article 49(1)(g) of the CRR [and Article 60(h) of the CRR

(Legal basis: Article 49(2)(a) of the CRR) [and Article 60 of the CRR]

1. Incentives to redeem shall mean all features that provide, at the date of issuance, an expectation that the instrument is likely to be redeemed.

2. These shall include the following forms:

(a) a call option combined with an increase in the credit spread of the instrument if the call is not exercised;

(b) a call option combined with a requirement or an investor option to convert the instrument into a Common Equity Tier 1 instrument if the call is not exercised;

(c) a call option combined with a change in reference rate where the credit spread over the second reference rate is greater than the initial payment rate minus the swap rate;

(d) a call option combined with an increase of the redemption amount in the future;

(e) a remarketing option combined with an increase in the credit spread of the instrument or a change in reference rate where the credit spread over the second reference rate is greater than the initial payment rate minus the swap rate if the instrument is not remarketed;

(f) a marketing of the instrument in a way which suggests to investors that the instrument will be called.

Section 2

Conversion or write-down of the principal amount

Questions for consultation: Q12. Are the provisions on the procedures and timing surrounding a trigger event and the nature of the write-down sufficiently clear? Are there issues which need to be elaborated further? Q13. How would you assess the impact of the provisions to be applied to temporary write-downs and write-ups? For the purposes of this consultation, an example of the write-up mechanism is provided in Annex.

Article 20

Nature of the write-down of the principal amount under Article 49(1)(n) of the CRR

(Legal basis: Article 49(2)(b) of the CRR)

1. The following provisions shall apply to the write-down of the principal amount:

   (a) the aggregate amount to be written down shall be at least the amount needed to immediately return the institution's Common Equity Tier 1 ratio to the level laid down in point (a) of Article 51 of the CRR or, if this is not possible, the full principal value of the instruments;

   (b) the write down shall lead to an increase in equity, under the relevant accounting standards, that is eligible as Common Equity Tier 1 capital pursuant to Article 24 of the CRR. The amount of Additional Tier 1 instruments recognized in Additional Tier 1 items is limited to the minimum amount of Common Equity Tier 1 items that would be generated if the principal amount of the Additional Tier 1 instruments were fully written down;

   (c) the write-down shall apply on a pro rata basis to all holders of Additional Tier 1 instruments that include a similar write-down mechanism and an identical trigger level.

2. Where the write-down is permanent, any distributions payable after a write-down shall be based on the reduced amount of the principal.

3. For the write-down to be considered temporary, all of the following conditions shall be met:

   (a) all payments shall be cancelled while the write-down is in effect, until the nominal amount of the instrument is fully reinstated;

   (b) write-ups shall be based on profits after the institution has taken a formal decision confirming the final profits;

   (c) any write-up of the instrument shall be operated at the full discretion of the institution subject to the constraints arising from points (d) to (f) and there shall be no obligation for the institution to operate or accelerate a write-up under specific circumstances;

   (d) a write-up shall be operated on a pro rata basis among similar Additional Tier 1 instruments that have been subject to a write-down;

   (e) the maximum amount to be attributed to the write-up of the instrument shall be based on the profit multiplied by the sum of the nominal of all Additional Tier 1 instruments before write-down that have been subject to a write-down divided by the total Tier 1 capital of the institution. This calculation shall be made at the moment when the write-up is operated;

(f) the sum of any write-up amounts shall be treated as a payment that results in a reduction of Common Equity Tier 1 and shall be subject, together with other distributions on Common Equity Tier 1 instruments, to the restrictions relating to the Maximum Distributable Amount as laid down in Article 131 of the CRD, as transposed in national law or regulation.

Article 21

Procedures and timing for determining that a trigger event has occurred under Article 49(1)(n) of the CRR

(Legal basis: Article 49(2)(c)(i) and (iii) of the CRR)

The following procedures and timing shall apply:

(a) institutions shall have in place sound and effective procedures for an ongoing monitoring of their capital ratios. As soon as the institution has established that the Common Equity Tier 1 ratio has fallen below the level that activates conversion or write-down of the instrument at the level of application of the requirements as defined under Title II of the CRR, the management body or any other relevant body of the institution shall without delay determine that a trigger event has occurred and there shall be an irrevocable obligation to write-down or convert the instrument.

(b) where conversions or write-downs of an Additional Tier 1 instrument require approval by the General Assembly, such approval shall have to exist at the time of the issue of the instrument;

(c) the amount to be written-down or converted shall be determined as soon as possible and within a maximum period of one month from the time it is determined that the trigger event has occurred;

(d) the competent authority may require that the maximum period of one month referred to in point (c) is reduced in cases where it assesses that sufficient certainty on the amount to be converted or written down is established or in cases where it assesses that an immediate conversion or write-down is needed;

(e) the write-down or conversion shall take place immediately once the amount referred to in point (c) has been determined;

(f) where an independent review of the amount to be written down or converted is required according to the provisions governing the Additional Tier 1 instrument, or where the competent authority requires an independent review for the determination of the amount to be written down or converted, the management body or any other relevant body of the institution shall see that this is done immediately. Any such review shall be completed as soon as possible and shall not create impediments for the institution to write-down or convert the Additional Tier 1 instrument and to meet the requirements of points (c) to (e) of this paragraph.

Article 22

Procedures and timing for notifying the competent authority and the holders of the instrument under Article 49(1)(n) of the CRR

(Legal basis: Article 49(2)(c)(ii) of the CRR)

1. Where the management body or any other relevant body of the institution has determined that a trigger event has occurred in accordance with point (a) of Article 21, the institution shall immediately notify the competent authority and the holders of the Additional Tier 1 instruments that a trigger event has occurred and that the instrument will be written down or converted in accordance with the provisions governing the instrument.

2. Holders of the instruments shall be notified of the trigger event according to usual practices for such notifications. Those notifications shall take account of all relevant regulations.

Section 3

Features of instruments that could hinder recapitalisation

Article 23

Features of instruments that could hinder recapitalisation under Article 49(1)(o) of the CRR

(Legal basis: Article 49(2)(d) of the CRR)

Features that could hinder the recapitalisation of the institution shall include, in particular provisions that require the institution to compensate existing holders of own funds instruments if a new own funds instrument is issued.

Section 4

Use of special purposes entities for indirect issuance of own funds instruments

In the following draft RTS, the use of special purposes entities for indirect issuances of own funds instruments is clarified.
If a special purpose entity issues for example a Tier 2 capital to investors and upstreams the proceeds by investing in Tier 1 issued by an operating entity or the holding company of the group, the transaction shall be classified as Tier 2 capital for the consolidated group. Furthermore, the instrument issued by the operating entity or holding company shall also be classified as Tier 2 for all other requirements that apply to that entity, such as solo or sub-consolidated capital requirements and disclosure requirements.

Article 24

Use of special purposes entities for indirect issuance of own funds instruments under Article 49(1)(p) of the CRR

(Legal basis: Article 49(2)(e) of the CRR)

The following provisions shall apply in the use of special purposes entities for indirect issuance of own funds instruments:

(a) Where the institution or any other entity listed in points (p)(ii), (p)(iii), (p)(iv) and (p)(v) of Article 49(1) of the CRR and in points (n)(ii), (n)(iii), n(iv), n(v) of Article 60 of the CRR issues a capital instrument that is subscribed by a special purpose entity, this capital instrument shall not, at the level of the institution or of the above-mentioned entities, receive recognition as capital of a higher quality than the lowest quality of the capital issued to the special purpose entity and the capital issued to third parties by the special purpose entity. Such requirement applies at all levels of application of requirements (consolidated, sub-consolidated, individual levels).

(b) The rights of the holders of the instruments issued by the special purpose entity shall be no more favourable than if the instrument was issued directly by the institution or any other entity listed in points (p)(ii), (p)(iii), (p)(iv) and (p)(v) of Article 49(1) of the CRR and in points (n)(ii), (n)(iii), n(iv), n(v) of Article 60.

Chapter 3

General requirements

Section 1

Indirect holdings arising from index holdings

Explanatory text for consultation purposes According to Article 71(3) of the CRR, EBA shall develop draft regulatory technical standards to specify: a) the extent of conservatism required in estimates used as an alternative to the calculation of underlying exposure referred to in paragraph 1; b) the meaning of operationally burdensome for the purposes of paragraph 2. Questions for consultation: Q14. Are the provisions on indirect holdings arising from index holdings sufficiently clear? Are there issues which need to be elaborated further? Q15. How would you assess the meaning of operationnally burdensome and which circumstances would be considered as operationnally burdensome? Q16. How would you assess the cost of conducting look-through approaches vs structure-based approaches for the treatment of indirect holdings arising from index holdings?

Article 25

Indirect holdings arising from index holdings- extent of conservatism required in estimates for calculating exposures used as an alternative to the underlying exposures under Article 71(1) of the CRR

(Legal basis: Article 71(3)(a) of the CRR)

1. An indirect holding arising from an index holding comprises the proportion of the index invested in the Common Equity Tier 1, Additional Tier 1 and Tier 2 instruments of relevant entities included in the index. For the purpose of this Article, an index includes, but is not be limited to, index funds and indices of credit derivatives.

2. Where the monitoring by an institution on an ongoing basis of its underlying exposures to the capital instruments of relevant entities that are included in indices is deemed by the competent authority to be operationally burdensome, the institution may adopt a structure-based approach to estimating the value of the exposures.

3. When using a structure-based approach, an institution shall ensure in particular by means of the investment mandate of the index, that a

capital instrument of a relevant entity which is part of the index cannot exceed a maximum percentage of the index. This percentage shall be used as an estimate for the value of the holdings that shall be deducted from own funds.

4. In the event that an institution is unable to determine the maximum percentage as referred to in paragraph 3 and the index, in particular in accordance with its investment mandate, includes capital instruments of relevant entities, the institution shall take into account the full amount of the index holdings for the deduction from own funds.

5. Depending on the nature of the index (equity index or bond index), the deduction shall be operated on a corresponding deduction approach. In situations where the institution cannot determine the precise nature of the holding, the value of the holding shall be deducted from Common Equity Tier 1 capital.

Article 26

Indirect holdings arising from index holdings- Meaning of operationally burdensome under Article 71(2) of the CRR

(Legal basis: Article 71(3)(b) of the CRR)

1. For the purpose of this Article, operationally burdensome shall mean situations under which look-through approaches to capital holdings in relevant entities on an ongoing basis is unjustified because of the low materiality of such positions.

2. In their assessment of the nature of operationally burdensome situations, competent authorities may take into account the following:

   (a) low net exposure to the capital of the relevant entity relative to the institution's total own funds;

   (b) a holding period of short duration, where the strong liquidity of the index can be evidenced.

Section 2

Supervisory consent for reducing own funds

Explanatory text for consultation purposes

According to Article 73(3) of the CRR, EBA shall adopt draft regulatory technical standards to specify the following:

(a) the meaning of sustainable for the income capacity of the institution;
(b) the appropriate bases of limitation of redemption referred to in paragraph 2;
(c) the process and data requirements for an application by an institution for the consent of the competent authority to carry out an action listed in Article 72, including the time period for processing such application

The RTS on point (b) of Article 73(3) has been included in the RTS on Article 27(6) because they are deemed to cover the same topic.

The RTS also includes an additional article on redemptions, reductions and repurchases announced by the institution and which shall be deducted from own funds when there is sufficient certainty that they will take place. This provision comes from CEBS/EBA guidelines on core capital published in June 2010 and EBA deems it necessary to keep this provision in the future regulatory framework.

A call or redemption feature is described in a legal or contractual provision allowing the issuer to call the full amount of the instrument. Such a formal call or redemption is distinguished from partial repurchases in the market at market terms and discretionary reductions of Common Equity Tier 1 capital in a manner that is permitted under applicable national law. However, reductions of Common Equity Tier 1 capital will involve redemption in the cases where the holders of the instruments have a right to return their shares to the issuing institution.

Questions for consultation:

Q17. How would you assess the levels of the thresholds for market making purposes (identical for hybrid instruments to the ones provided by CEBS/EBA guidelines on hybrid instruments published in December 2009) for competent authorities to give a prior consent (Article 29)?

Q18. How would you assess the impact of the proposed timing of 3 months for the submission of the application (Article 31)?

Q19. How would you assess the levels of the thresholds for the non-materiality of the amounts to be redeemed for mutuals, cooperative societies or similar institutions (Article 32)?

Article 27

Meaning of sustainable for the income capacity of the institution under Article 73(1)(a) of the CRR

(Legal basis: Article 73(3)(a) of the CRR)

Sustainable for the income capacity of the institution shall mean that the profitability of the institution, as assessed by the competent authority, continues to be sound after the replacement of the instruments with own funds instruments of equal or higher quality, at that date and for the foreseeable future. This judgment shall take into account an assessment of the institution's profitability in stress situations.

Article 28

Process and data requirements for an application by an institution to carry out redemptions, reductions and repurchases - under Article 72(b) of the CRR

(Legal basis: Article 73(3)(c) of the CRR)

1. Redemptions, reductions and repurchases of own funds instruments shall not be announced to holders of the instruments before the institution has obtained the prior approval of the competent authority.

2. Where redemptions, reductions and repurchases are expected to take place with sufficient certainty, and once the prior approval of the competent authority has been obtained, the corresponding estimated amounts to be redeemed, reduced or repurchased shall be deducted from corresponding elements of own funds before the effective redemptions, reductions or repurchases occur. Sufficient certainty is deemed to exist in particular when the institution has publicly announced its intention to redeem, reduce or repurchase an own funds instrument.

Article 29

Submission of application by the institution to carry out redemptions, reductions and repurchases under Article 72(b) of the CRR

(Legal basis: Article 73(3)(c) of the CRR)

1. The institution shall submit an application to the competent authority before reducing or repurchasing Common Equity Tier 1 instruments or calling, redeeming or repurchasing Additional Tier 1 or Tier 2 instruments.

2. The application may include a plan to carry out actions listed in Article 72 of the CRR for several capital instruments in the near future.

3. Where an institution is repurchasing a Common Equity Tier 1 instrument, an Additional Tier 1 instrument or a Tier 2 instrument for market making purposes, competent authorities may give in advance their prior consent to carry out an action listed in Article 72 of the CRR for a certain predetermined amount. This is under the following conditions:

   (a) the amount of Common Equity Tier 1 instrument to be repurchased in these circumstances shall not exceed 3% of the relevant issuance or 10% of the excess of the amount of Common Equity Tier 1 compared to the sum of the minimum Common Equity Tier 1 capital requirements pursuant Article 87 of the CRR, the specific own funds requirements referred to in Article 100 of the CRD and the combined buffer referred to in Article 122(2) of the CRD, whichever of the two limits is the lower;

   (b) the amount of Additional Tier 1 instrument or Tier 2 instrument to be repurchased in these circumstances shall not exceed 10% of the relevant issuance or 3% of the total amount of outstanding Additional Tier 1 instruments or Tier 2 instruments respectively, whichever of the two limits is the lower.

4. Competent authorities may lower the limits indicated in points (a) and (b) of paragraph 3 and remove at any time the prior consent they may have granted in advance.

5. Paragraph 3 may also be applied where own funds instruments are passed on to employees of the institution as part of their remuneration. Institutions shall inform competent authorities where own funds instruments are purchased for these purposes and deduct these instruments from own funds on a corresponding deduction approach for the time they are held by the institution.

6. A competent authority may give in advance its prior consent to carry out an action listed in Article 72 of the CRR for a certain predetermined amount when the amount of own funds instruments to be called, redeemed or repurchased is immaterial in relation to the outstanding amount of the corresponding issuance after the call, redemption or repurchase has taken place.

Article 30

Content of the application to be submitted by the institution under Article 72(b) of the CRR

(Legal basis: Article 73(3)(c) of the CRR)

1. The application referred to in Article 29 shall be accompanied by all necessary information allowing the competent authority to conduct its assessment on the potential impact of one of the actions listed in Article 72 of the CRR on the financial and solvency position of the institution.

2. The institution shall, to the satisfaction of the competent authority, submit at least the following information:

   (a) a well-founded explanation of the rationale for performing one of the actions referred to in paragraph 1;

   (b) an information on capital requirements and capital buffers, covering at least a 3 year period, including the level and composition of own funds before and after the performing of the action and the impact of the action on regulatory requirements;

   (c) the impact on the profitability of the institution of a replacement of a capital instrument as specified in point (a) of Article 73(1);

   (d) an evaluation of the risks to which the institution is or might be exposed and whether the level of own funds ensures an appropriate coverage of such risks, including stress tests on main risks evidencing potential losses under different scenarios.

3. The competent authority may waive the submission of some of the information listed in paragraph 2 in particular in cases where this information is already available to the authority.

Article 31

Timing of the application to be submitted by the institution and processing of the application by the competent authority [Article 72(b) of the CRR]

(Legal basis: Article 73(3)(c) of the CRR)

1. The institution shall transmit a complete application and the information referred to in Articles 29 and 30 to the competent authority at least 3 months in advance of the date where one of the actions listed in Article 72 of the CRR will be announced to the holders of the instruments.

2. The competent authority shall process an application during the period of time referred to in paragraph 1. Competent authorities shall take into

account new information, if any and if deemed material, received during this period. The processing of the application shall begin only when competent authorities are satisfied that the information required under Article 28 has been received from the institution.

3. Competent authorities may allow institutions on a case-by-case basis and under exceptional circumstances to transmit the application referred to in paragraph 1 within a time frame shorter than the 3 months period.

Article 32

Applications for redemptions, reductions and repurchases by mutuals, cooperative societies or similar institutions under Article 72(b) of the CRR

(Legal basis: Article 73(3)(c) of the CRR)

1. With regard to the redemption of Common Equity Tier 1 instruments of mutuals, cooperative societies or similar institutions, the application and information referred to in Articles 29 and 30 shall be submitted to the competent authority with the same frequency as that used by the competent body of the institution to examine redemptions.

2. Where the amounts to be redeemed are not material, the competent authority may give in advance its prior consent to carry out an action listed in Article 72 of the CRR. The amount is deemed to be material when the amount to be redeemed, net of the amount of the subscription of new paid in Common Equity Tier 1 instruments during the period, exceeds 3% of Common Equity Tier 1 capital per year or 10% of the excess of the amount of Common Equity Tier 1 compared to the sum of the minimum Common Equity Tier 1 capital requirement pursuant Article 87 of the CRR, the specific own funds requirements referred to in Article 100 of the CRD and the combined buffer referred to in Article 122(2) of the CRD whichever of the two limits is the lower.

3. Competent authorities may lower the limits indicated in paragraph 2 and remove at any time the prior consent they may have granted in advance.

Section 3

Temporary waiver from deduction from own funds

Explanatory text for consultation purposes

According to Article 74(2) of the CRR, EBA shall develop draft regulatory technical standards to specify the concept of temporary for the purposes of paragraph 1 and the conditions according to which a competent authority may deem the temporary holdings referred to be for the purposes of a financial assistance operation designed to reorganise and save a relevant entity.

The provisions drafted in this RTS will be revised according to the final EU provisions on Resolution and crisis management, as well as the final version of the CRR, to the extent necessary.
It can also be noted that a financial assistance operation may happen before the resolution stage.

Q20. The EBA is considering setting a time limit the waiver shall not exceed. This time limit would be set up at a maximum of 5 years and a lower time limit could also be considered. Which time limit, within a maximum of 5 years, would you find appropriate?

Article 33

Temporary waiver from deduction from own funds under Article 74(1) of the CRR

(Legal basis: Article 74(2) of the CRR)

1. 'Temporary' shall mean of a duration that does not exceed the timeframe envisaged under the financial assistance operation plan. [*The waiver shall not be granted for a period longer than 5 years*.

2. Further, 'temporary' shall mean waiver in relation only to new holdings of instruments in the relevant entity subject to the financial assistance operation.

3. For the purposes of providing a temporary waiver for deduction from own funds, a competent authority may deem the temporary holdings referred to be for the purposes of a financial assistance operation designed to reorganise and save a relevant entity where the operation is carried out under a plan and approved by the competent authority, and where the plan clearly states phases, timing and objectives and specifies the interaction between the temporary holdings and the financial assistance operation.

TITLE III

Minority interest and Additional Tier 1 and Tier 2 instruments issued by subsidiaries

Article 34

The meaning of minimal and insignificant regarding qualifying Additional Tier 1 and Tier 2 capital issued by a special purpose entity under Article 78(1) of the CRR

(Legal basis: Article 78(2) of the CRR)

Explanatory text for consultation purposes According to Article 78(2) of the CRR, EBA shall develop draft regulatory technical standards to specify the concepts of minimal and insignificant referred to in point (d) of paragraph 1. Questions for consultation: Q21. Would you assess the limit on the amount of assets set at 0.5% of the average total assets of the special purpose entity over the last three years as appropriate? Q22. How would you assess the impact of setting the limit at 0%, meaning keep only the possibility offered by point (a)?

The assets of a special purpose entity shall be considered to be minimal and insignificant where:

(a) the assets of the special purpose entity which are not constituted by the investments in the own funds of the related subsidiary are limited to cash assets dedicated to payment of coupons and redemption of the own funds instruments that are due, and;

(b) the amount of other assets of the special purpose entity different from the ones mentioned in point (a) are not higher than 0.5% of the average total assets of the special purpose entity over the last three years.

TITLE IV

Qualifying holdings outside the financial sector

Article 35

Risk weighting and prohibition of qualifying holdings outside the financial sector under Article 84(1)(b) of the CRR

(Legal basis: Article 84(4) of the CRR)

Explanatory text for consultation purposes According to Article 84(4) of the CRR, EBA shall develop draft regulatory technical standards to specify: (a) activities that are a direct extension of banking; (b) activities that concern services ancillary to banking; (c) similar activities for the purposes of point (b)(iii) of paragraph 1. This RTS will be part of a separate consultation.

TITLE V

General requirements, valuation and reporting

Article 36

Own funds requirements for investment firms based on Fixed Overheads under Article 92(1), (2) and (3) of the CRR

(Legal basis: Article 92(4) of the CRR)

Explanatory text for consultation purposes According to Article 92(4) of the CRR, EBA shall develop draft regulatory technical standards to specify in greater detail the following: (a) the calculation of the requirement to hold eligible capital of at least one quarter of the fixed overheads of the previous year; (b) the conditions for the adjustment by the competent authority of the requirement to hold eligible capital of at least one quarter of the fixed overheads of the previous year; (c) the calculation of projected fixed overheads in the case of an investment firm that has not completed business for one year. This RTS will be part of a separate consultation.

TITLE VI

Specification of the transitional provisions of the CRR in relation to Own Funds

Chapter 1

Own funds requirements, unrealised gains and losses measured at fair value and deductions

Article 37

Additional filters and deductions under Article 461(1) of the CRR

(Legal basis: Article 461(4) of the CRR)

Explanatory text for consultation purposes According to Article 461(4) of the CRR, EBA shall develop draft regulatory technical standards to specify the conditions according to which competent authorities shall determine whether adjustments made to own funds, or elements thereof, in accordance with national transposition measures for Directive 2006/48/EC or Directive 2006/49/EC that are not included in Part Two should for the purposes of this Article be made to Common Equity Tier 1 items, Additional Tier 1 items, Tier 1 items, Tier 2 items or own funds.

1. The adjustments to Common Equity Tier 1 items, Additional Tier 1 items and Tier 2 items, shall be applied as follows:

2. The adjustment shall be made to Common Equity Tier 1 items when, under the transposition measures of the Directive 2006/48/EC and the Directive 2006/49/EC, those deductions and filters result from own funds items as referred to in Article 57(a) to (c) of Directive 2006/48/EC;

3. Unless point 2 applies, the adjustment shall be made to Additional Tier 1 items when, under the transposition measures of the Directive 2006/48/EC and the Directive 2006/49/EC, these deductions and filters have been applied to the total of the items as defined referred to in Article 57(a) to (ca) of the Directive 2006/48/EC, taking into account Article 154.

   When the amount of Additional Tier 1 items is lower than the related adjustment, the residual adjustment shall be made to Common Equity Tier 1 items;

4. Unless point 2 or 3 apply, the adjustment shall be made to Tier 2 items when, under the transposition measures of the Directive

2006/48/EC and the Directive 2006/49/EC, these deductions and filters have been applied to own funds items as referred to in Article 57(d) to (h) or total own funds of Directive 2006/48/EC and Directive 2006/49/EC,.

When the amount of Tier 2 items is lower than the related adjustment, the residual adjustment shall be made to Additional tier 1 items. When the amount of Tier 2 and Additional Tier 1 items is lower than the related adjustment, the residual adjustment shall be made to Common equity Tier 1 items.

Chapter 2

Grandfathering of capital instruments for elements not constituting State Aid

Article 38

Items excluded from grandfathering in Common Equity Tier 1 or Additional Tier 1 items in other elements of own funds under Article 465(1) and (2)

(Legal basis: Article 465(3) of the CRR)

Explanatory text for consultation purposes According to Article 465(3) of the CRR, EBA shall develop draft regulatory technical standards to specify the conditions for treating own funds instruments referred to in paragraphs 1 and 2 as falling under Article 464(4) or 464(5) during the period from 1 January 2013 to 31 December 2021. The provisions in Article 465(3) allow for excess grandfathered Common Equity Tier 1 or Additional Tier 1 instruments to be included within the grandfathering buckets for lower tiers. The grandfathering buckets are: the amount eligible for grandfathering further to Article 463(3) for Common Equity Tier 1; the amount eligible for grandfathering further to Article 463(4) Additional Tier 1; and the amount eligible for grandfathering further to Article 463(5) for Tier 2. Excess in this case is defined as amounts that are excluded from those grandfathering buckets solely due to the amount exceeding the applicable percentage permitted for that bucket. Any inclusion in a lower bucket is only possible if there is sufficient headroom to accommodate the additional recognition in that bucket.

1. Where treating own funds instruments referred to in paragraphs 1 and 2 of Article 465 of the CRR as falling under Article 463(4) or 463(5) during the period from 1 January 2013 to 31 December 2021, instruments may be reclassified either in whole or in part. Any reclassification shall have no effect on the calculation of the limit as specified in Article 464(4).

2. Own funds instruments referred to in paragraph 1 may be reclassified as items referred to in Article 463(3) and 463(4) of the CRR provided that their amount no longer exceeds the applicable percentages referred to in Articles 464(2) and 464(3) respectively.

TITLE VII

Final provisions

Article 39

This Regulation shall enter into force on the day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

For the Commission
The President

[For the Commission
On behalf of the President

[Position]

ANNEX – example of a write-up mechanism (only for consultation purposes)

The example provided below is meant to illustrate the formula for the write-up mechanism as provided in Article 20(3) point (e) of the draft RTS: the maximum amount to be attributed to the write-up of the instrument shall be based on the profit multiplied by the sum of the nominal of all Additional Tier 1 instruments before write-down that have been subject to a write-down divided by the total Tier 1 capital of the institution.

This example is not meant to cover all possible situations but has been designed to be kept simple. The example will not be part of the final RTS.

	A	B	C	D	E	F
3		**Before losses**	**after losses**	**after losses and write down**	*Formula used for calculations in column D*	
4	common equity tier 1 before losses	1,000	1,000	1,000		
5	losses		-500	-500		
6	write down of the additional tier 1 instrument			141	((5.125/100)-C13)*C12	
7	**common equity after losses and write down of the additionnal tier 1 instrument**	**1,000**	**500**	**641**	SUM(D4:D6)	
8	additional tier 1 capital before write down	200	200	200		
9	write down of the additional tier 1 instrument			-141	-D6	
10	**additional tier 1capital after write down**	**200**	**200**	**59**	SUM(D8:D9)	
11	**total tier 1 capital**	**1,200**	**700**	**700**	D7+D10	
12	*RWA*	*12,500*	*12,500*	*12,500*		
13	*common equity tier 1 ratio*	*8.0%*	*4.0%*	*5.1%*	D7/D12	
14	*tier 1 ratio*	*9.6%*	*5.6%*	*5.6%*	D11/D12	
15						
16						
17						
18		**year 1**	**year 2**	**year 3**	**year 4**	*Formula used for calculations in column D*
19	**common equity tier 1 ratio at the beginning of the year**	**5.1%**	**5.9%**	**6.4%**	**6.7%**	=C37
20	**result of the year**	100	100	100	100	
21	- % attributed to shareholders	71.4%	75.0%	77.4%	78.9%	(C35-D8)/C35)
22	- amount attributed to shareholders	71	75	77	79	D21*D20
23	- % attributed to the write up	28.6%	25.0%	22.6%	21.1%	D8/C35
24	**- Limit 1 : amount attributable to the write up**	**29**	**25**	**23**	**21**	D20*D23
25	**- Limit 2 : MDA pursuant to article 131 of the CRD**	**0**	**40**	**60**	**60**	D20*0.6 (a)
26						
27	**common equity tier 1 before write up**	**641**	**741**	**801**	**841**	C31
28	result of the year	100	100	100	100	D20
29	result of the year used to write up additional tier 1 instruments	0	-25	-23	-21	-MIN (D24,D25)
30	dividends to shareholders	0	-15	-37	-39	-(D25+D29)
31	**common equity tier 1 after write up**	**741**	**801**	**841**	**881**	SUM(D27:D30)
32	**additional tier 1 capital before write up**	**59**	**59**	**84**	**107**	C34
33	result of the year attributed to additional tier 1 holders	0	25	23	21	D24
34	**additional tier 1 capital after write up**	**59**	**84**	**107**	**128**	SUM(D32:D33)
35	**total Tier 1 capital**	**800**	**885**	**948**	**1,009**	D31+D34
36	*RWA*	*12,500*	*12,500*	*12,500*	*12,500*	
37	*common equity tier 1 ratio*	*5.9%*	*6.4%*	*6.7%*	*7.0%*	D31/D36
38	*tier 1 ratio*	*6.4%*	*7.1%*	*7.6%*	*8.1%*	D35/D36
39	*(a) calculation of 0.6 based on the restrictions to be applied when an institution enters the capital conservation buffer range*					
40	*in this case, a CET1 ratio of 6,4% means 40% of earnings to be retained so a maximum distributable amount (MDA) of 100*60%=60*					

V. Accompanying documents

a. Draft Costs-Benefits Analysis

The CRR requires the EBA to develop draft Regulatory Technical Standards (RTS) related to Own Funds.

As per Article 10(1) third subparagraph of the EBA regulation, any draft Technical Standards developed by the EBA - when submitted to the European Commission for adoption - will have to be accompanied by an analysis of the potential related costs and benefits unless such analysis is disproportionate in relation to the scope and impact of the draft RTS concerned or in relation to the particular urgency of the matter. The costs-benefits analysis aims to provide the reader with an overview of findings as regards the problem identification, the options identified for removing the problem and their potential impacts.

The present part deals with costs-benefits analysis and impact assessment regarding the RTS on own funds.

Throughout the elaboration of the draft RTS, EBA has closely followed the work of international organisations dealing with related topics, in particular the Basel Committee on Banking Supervision (BCBS).

The BCBS published in December 2010 its "global regulatory framework for more resilient banks and banking systems" aiming at addressing the lessons of the financial crisis[14]. The BCBS is raising the resilience of the banking sector in particular by strengthening the regulatory capital framework. The reforms raise both the quality and quantity of the regulatory capital base.

The BCBS underlined that the global banking system entered the crisis with an insufficient level of high quality capital. The crisis also revealed the inconsistency in the definition of capital across jurisdictions and the lack of disclosure that would have enabled the market to fully assess and compare the quality of capital across jurisdictions. A key element of the new definition of capital is the greater focus on common equity, the highest quality component of a bank's capital.

In the process of defining new eligibility criteria for capital instruments, the Basel Committee conducted a comprehensive quantitative impact study in order to ascertain in particular the impact of its new requirements to raise the quality and level of the capital base[15]. The impact study focused in particular on the changes to the definition of capital resulting in a new capital standard, referred to as Common Equity Tier 1 (CET1), a reallocation of deductions to CET1 and changes to the eligibility criteria for Tier 1 and total capital.

In the same way as in the BCBS proposals, the European Commission, when publishing the CRR proposal, underlined that institutions entered the crisis with capital of insufficient quantity and quality. Given the risks they faced, many institutions did not possess sufficient amounts of the highest quality capital instruments that can absorb losses effectively as they arise and help to preserve an institution as a going concern.

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[14] Revised version published on 1 June 2011.

[15] http://www.bis.org/publ/bcbs186.pdf

The CRR/CRD IV proposals related to own funds translate the BCBS proposals into EU law, while taking into account EU specificities, in particular for example with respect to the cooperative banking sector. The draft RTS as put forward by the EBA for this consultation derive directly from the CRR/CRD IV proposals.

The European Commission performed a comprehensive impact assessment covering in particular the proposed changes in the definition of capital[16]. In the process of preparing the legislative proposal, a number of policy alternatives on various individual aspects of the definition of regulatory capital have been examined by the European Commission and the different policy options have been assessed in terms of effectiveness and efficiency. The cumulative impact of the CRR/CRD IV proposals in terms of additional capital that the EU banking industry needs to raise, administrative costs, economic impact in the transitional period, as well as long term economic impact, have been assessed.

The Committee of European Banking Supervisors (CEBS), as predecessor of the EBA, conducted a comprehensive quantitative impact study on the impact of the foreseen regulatory changes on the EU banking industry[17].

The EBA is also in regular contact with industry experts whose input has been used for the most technical parts of the drafts RTS. Some of the draft RTS are more directly targeted at mutuals, cooperative banks or similar institutions. The EBA consults regularly the EU cooperative sector in order to ensure a proper understanding of the specificities of this sector in terms of own funds and to assess the impacts of the draft RTS.

The EBA has included in this consultation a number of questions whose answers will complement the already existing costs-benefits analyses and will allow finalizing the RTS for submission to the European Commission. All RTS included in this consultation paper have to be submitted to the European Commission by 1 January 2013.

[16] http://ec.europa.eu/internal_market/bank/docs/regcapital/CRD4_reform/IA_regulation_en.pdf

[17] http://eba.europa.eu/Publications/Quantitative-Impact-Study.aspx

b. Overview of questions for Consultation

TITLE II

Elements of own funds

Q01. Are the provisions on the meaning of foreseeable when determining whether any foreseeable charge or dividend has been deducted sufficiently clear? Are there issues which need to be elaborated further? What would be your definition of foreseeable?

Q02. Are the provisions on the applicable forms of indirect funding of capital instruments sufficiently clear? Are there issues which need to be elaborated further?

Q03. How do you assess the provisions on related parties regarding the necessity to assess on an on-going basis that the related party has sufficient revenues?

Q04. Are the provisions on the limitations on redemption of own funds instruments sufficiently clear? Are there issues which need to be elaborated further?

Q05. How would you assess the impact of documenting decisions on redemptions?

Q06. How would you assess the cost impact of including in the provisions of the instruments criteria as listed in paragraphs 2 and 3? *(please note that the CRR requires in point (b) of Article 27 (2) that where the refusal by the institution of the redemption of instruments is prohibited under applicable national law, the provisions governing the instruments shall give the institution the ability to limit their redemption).*

Q07. Are the provisions on the deductions related to losses for the current financial year, deferred tax assets, defined pension fund assets and foreseeable tax charges sufficiently clear? Are there issues which need to be elaborated further?

Q08. Are the provisions on the types of capital instruments of financial institutions, third country insurance and reinsurance undertakings, and undertakings excluded from the scope of Directive 2009/138/EC in accordance with Article 4 of that Directive that shall be deducted from the following elements of own funds sufficiently clear? Are there issues which need to be elaborated further?

Q09. How would you assess the impact of operating a deduction from Common Equity Tier 1 items? *(linked to immediate previous question)*

Q10. Are the provisions related to the requirements for cooperative networks sufficiently clear?

Q11. Would you agree on the types of incentives to redeem as described in paragraph 2 of article 19? Should other types of situations be considered as incentives to redeem?

Q12. Are the provisions on the procedures and timing surrounding a trigger event and the nature of the write-down sufficiently clear? Are there issues which need to be elaborated further?

Q13. How would you assess the impact of the provisions to be applied to temporary write-downs and write-ups?

Q14. Are the provisions on indirect holdings arising from index holdings sufficiently clear? Are there issues which need to be elaborated further?

Q15. How would you assess the meaning of operationnally burdensome and which circumstances would be considered as operationnally burdensome?

Q16. How would you assess the cost of conducting look-through approaches vs structure-based approaches for the treatment of indirect holdings arising from index holdings?

Q17. How would you assess the levels of the thresholds for market making purposes (identical for hybrid instruments to the ones provided by CEBS/EBA guidelines on hybrid instruments published in December 2009) for competent authorities to give a prior consent (Article 29)?

Q18. How would you assess the impact of the proposed timing of 3 months for the submission of the application (Article 31)?

Q19. How would you assess the levels of the thresholds for the non-materiality of the amounts to be redeemed for mutuals, cooperative societies or similar institutions (Article 32)?

Q20: The EBA is considering setting a time limit that the temporary waiver from deduction from own funds shall not exceed. This time limit would be set up at a maximum of 5 years and a lower time limit could also be considered. Which time limit, within a maximum of 5 years, would you find appropriate?

TITLE III

Minority interest and Additional Tier 1 and Tier 2 instruments issued by subsidiaries

Q21. Would you assess the limit on the amount of assets set at 0.5% of the average total assets of the special purpose entity over the last three years as appropriate?

Q22. How would you assess the impact of setting the limit at 0%, meaning keep only the possibility offered by paragraph (a)?