

## **POSITION PAPER**

July, 2012

**CECA´s contribution to EBA Consultation on  
“DRAFT REGULATORY TECHNICAL STANDARDS ON  
OWN FUNDS – PART ONE” (EBA/CP/2012/02)**



## 1. INTRODUCTION

CECA is the Spanish Confederation of Savings Banks and is also a credit institution with no specific limitation which provides the savings banks products and services within the technological and financial area. CECA plays an important role in the Spanish savings bank sector and one of its main objectives is to represent its members, with the aim of strengthening the competitive advantage of this important sector of Spain's financial system, which accounts for half of the Spanish market (both in terms of loans and deposits).

The Spanish Savings Banks welcome the efforts of the European Banking Authority to develop the draft Regulatory Technical Standards in accordance with the mandate contained in several articles of the CRR.

CECA welcomes the opportunity to comment on the first set of Draft Regulatory Technical Standards on Own Funds (EBA/CP/2012/02) elaborated by the EBA.

In this document we include those aspects that are especially relevant for the Spanish Savings Banks. For the remaining topics we adhere to the position of the European Savings Banks Group (ESBG).



## 2. COMMENTS AND DOUBTS ARISED BY THE CONSULTATIVE DOCUMENT

### 1. DEDUCTIONS FROM COMMON EQUITY TIER 1 ITEMS:

***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?***

In order to clarify the requirements of national tax laws for the conversion of the deferred tax assets into claims on the central governments described in article 36.2 (c) of the CRR, it should be clarified that it would be enough that such conversion operates only in one of the three events foreseen in said article (loss, insolvency or liquidation) without being necessary that it operates in each and every one of them. This clarification would avoid uncertainties on the scope that the reforms of the different national tax laws may require for making effective this specific exemption of the deduction from Common Equity Tier 1 (CET1), if so desired.

### RATIONALE

The rationale to impose a deduction of certain deferred tax assets from CET1 is that, under certain conditions, deferred tax assets might not have any realization value (e.g. should the institution be liquidated). Accordingly, once a national tax rule guarantees the realization value in events such as insolvency and liquidation, the deduction of these deferred tax assets from CET1 is not justifiable.

Because it would result in a disproportionate requirement, it is important to avoid the interpretation that for the purposes at hand, the conversion into claims on the central government of deferred tax assets should always operate in the case of losses. In many circumstances deferred tax assets still maintain a realization value even in the case losses are



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incurred: hence, losses can be of an extraordinary nature, can be non-recurrent, or can be incurred for amounts which are low or that do not generate a risk of insolvency or liquidation. For instance, it would not make sense that a national tax law has to recognize the conversion into a claim on the central government of such deferred tax asset if there is a loss of a low amount, if this tax law already recognizes such conversion in the events of either insolvency or liquidation. Of course conversion of a deferred tax asset into a claim on the central government in the case of losses should be an option that a government may decide to use, but not mandatory in itself.

Furthermore, in the case of credit institutions, the liquidation of the company and insolvency proceedings are often simultaneous. Although it is theoretically possible that any of these situations takes place separately it should be enough from a prudential point of view that the tax rules provide for the transformation in only one situation to ensure the effectiveness of the capital.

Liquidation needs not always to be accompanied by an insolvency procedure, as it is possible that the net equity is sufficient to meet the demands of depositors and satisfy all remaining creditors, regardless of the rank of their claims. In any case, if liquidation is not accompanied by an insolvency proceeding, and the tax legislation does not provide for the conversion into a claim of deferred tax assets in this scenario, the proceeds from the realization of assets (not including the mentioned deferred tax assets) should be sufficient to repay all debts of the entity. Therefore, the fact that the deferred tax assets have not been converted into a claim is not relevant from a prudential point of view because only the ordinary shareholders will be affected.

With respect to insolvency proceedings, it can be observed that unlike the business of any company in other economic sectors, the activity of a credit institution is based on the confidence of depositors and other creditors and, once this has disappeared, its viability as an independent entity is extremely difficult. Thus, if insolvency is not a triggering event, the possible intervention by the public sector, taking control of the entity, should be resolved in a short period of time with the liquidation of the said entity or their transfer, conveniently capitalized, to private hands. In the first case, the deferred tax assets would become claims on the central government, in the second, would retain its value realization, because the injection of new capital will enable future profits.



## **PROPOSAL**

It is proposed that for the avoidance of doubts the EBA clarifies in its final Regulatory Technical Standards, with respect to the requirements of national tax laws for the conversion of the deferred tax assets into claims on the central governments described in article 36.2 (c) of the CRR, that these requirements are met if the conversion operates only in one of the three events foreseen in said article (loss, insolvency or liquidation) without being necessary that it operates in each and every one of them.

### **2. ADDITIONAL TIER 1 CAPITAL:**

#### ***General comments on articles 19 to 22***

Hybrid instruments, such as convertible bonds, are fixed income instruments with a limited return, but they have the peculiarity that when a contingency occurs they get converted into equity securities, with a level of risk more similar to the one assumed by shareholders. That is, they are limited on the upside, but not on the downside. This asymmetry in terms of risk and return makes these instruments less attractive than shares because they lose one of their main features: a low risk level.

For these reasons, it is necessary that their characteristics, especially those related to their conversion into shares and their level of seniority, are carefully designed to make them more attractive to investors. Otherwise, creating a market for these instruments may not be feasible.

### **3. GENERAL REQUIREMENTS:**

#### ***General comments on articles 27 to 33***

Regarding the supervisory consent for reducing own funds related with article 73 of CRR, it is necessary to take into account the negative consequences that a highly prescriptive approach could have. Due to this, it is our view that national supervisors should have a certain degree of



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flexibility, in order to be able to react appropriately when the conditions to grant a reduction of the institutions' own funds are met.

#### **4. GRANDFATHERING OF CAPITAL INSTRUMENTS FOR ELEMENTS NOT CONSTITUTING STATE AID:**

##### ***General comments on article 38***

We think that the application of the proportionality principle needs also to be considered when talking about transitional periods. Due to this, and taking into consideration the specificities of the financial sector and current economic conditions, we consider that all current capital instruments under national law should be grandfathered over a transitional period of at least ten years, in order to allow financial institutions enough time to adapt themselves to the new regulation.