

**EBF COMMENTS ON DRAFT REGULATORY TECHNICAL STANDARDS  
ON OWN FUNDS – PART ONE**

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**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?**

- We agree, in general, with what the consultation paper proposes in this respect.

However, Article 2, § 4, (a), should be deleted as an average of payments over a couple of years is not useful to predict payments. As the recent crisis has shown, long established habits may be wrong if special circumstance occur. Therefore, to take into account only the last year's payout ratio, as referred to in the proposed Article 2, §4, (b), should be taken into account.

- In general, the explanations provided are sufficiently clear. It would, however, be useful to clarify the following:
  - the foreseeable dividend must be estimated considering the effective decrease in equity only. Therefore, only cash dividends are subject to deduction whilst other types of dividends (such as scrip dividends) do not need to be deducted.
  - there is no requirement for the management body to make its dividend policy publicly available;
  - restrictions on payments (e.g. if buffers are breached) should also be taken into account to compute the foreseen distribution;
  - the "average payout" does not have to be computed on the statutory Profit and Loss Account if the institution's avowed policy is to compute the payout on the basis of the consolidated Profit and Loss Account.
- It is unclear to us how Article 2, §7, is supposed to work in practice. According to the proposal, foreseeable dividends can be deducted only provided that the competent authorities have consented to it (after having examined if all necessary deductions to the profits related to foreseeable changes have been made). However, in general, the time which elapses between the moment at which the institution has calculated the final interim or year-end profits and the moment at which it publishes the capital ratios is very short. As a consequence, there may not be sufficient time available to the competent authorities to allow for a thorough decision of the competent authorities on the foreseeable charges.

## ARTICLES 4 & 5

### **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?**

- It is our understanding that indirect funding of an institution's capital instruments as referred to in the proposed Article 6, §1 (c) can refer only to those types of funding that have been made deliberately with the intention that the borrower finances the institution's own capital instruments.

Anyway, it would not be possible, from a practical perspective, for an institution to be (or become) aware of all those situations where (i) the borrower uses the funding to buy capital instruments of the funding institution or (ii) the borrower transfers the funding to another investor that is buying capital instruments of the funding institution. Therefore, Article 6, §1, (b), should be amended as follows:

*“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~~ **material** 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;”*

- It would be useful clarifying that intra-group transactions conducted in normal course of business (e.g. within the framework of intra-group cash management) are not affected by the provisions.

### **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?**

Article 26, §3, CRR provides the EBA with a mandate to develop draft regulatory standards to specify “the applicable forms and nature of indirect funding of capital instruments. However, what is being proposed in Article 6, §1, (d) does not address indirect funding of the purchase of an institution's capital instruments but loans to related third parties for other purposes than purchasing an institution's own capital instruments. Therefore, the proposed goes beyond the mandate which has been conferred to the EBA. It should, therefore, be deleted.

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

We agree with what is being proposed in Article 7. The provisions are sufficiently clear. We feel, however, that concepts or definitions that are already set in an accounting context should not be reintroduced into the regulatory framework unless this is absolutely necessary. In our opinion, CRR / CRD IV already include all necessary aspects with respect to distributions. We therefore believe the definition of “distributable items” to be superfluous.

It would, however, be useful for the proposed Regulatory Technical Standard to address the situation of coupons that are distributed on the basis of Additional Tier 1 instruments that need to be qualified as debt from a legal point of view to take into account that coupons are not paid “*out of*” distributable items (as these are reserved to shareholders). We would like to suggest, in particular, that the Technical Standard would clarify that institutions are required to include in the contractual terms governing such instruments a clause stating that if coupons are higher than statutory distributable items, the institution will be prohibited from paying the amount of coupons thus exceeding distributable items.

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

Our member banks may provide the EBA with input on this.

**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).***

Our member banks may provide the EBA with input on this.

**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?**

- One major issue which needs to be addressed in an appropriate way is the unlevel playing field that the proposals may create where pension fund assets are concerned, taking into account that the valuations rules applicable to institutions working under IFRS or those working under national GAAP differ. For example, according to IAS 19 under IFRS the net defined pension fund asset that may be included may not exceed "the present value of any economic benefit available in the form of refunds from the plan or reductions in future contributions to the plan" (the assets ceiling). It would be useful in order to reduce the unlevel playing field stemming from different national interpretations, if EBA could specify how the concept of "unrestricted ability to use the assets" in Article 13 corresponds with the restrictions on the inclusion of defined benefit pension funds assets according to the "assets

ceiling" in IAS 19. Are there further restrictions or can defined pensions fund assets be included beyond the asset ceiling ?

- Furthermore, the wording of Article 12, §3, would need to be amended. It states that the amount of associated deferred tax liabilities which are eligible for offsetting deferred tax assets that rely on future profitability is the difference between (a) the amount of deferred tax liabilities as recognised under the applicable accounting standards and (b) the amount of associated deferred tax liabilities arising from intangible assets and from defined benefit pension fund assets. It should be specified that both (a) and (b) refer to the **total** amount of deferred tax liabilities/ associated deferred tax liabilities.
- Concerning Article 13, it may be useful to clarify the following:
  - for those funds which account for all assets and liabilities, only the net amount needs to be deducted;
  - an internal requirement according to which the use of a pension fund asset needs prior approval from the bank's management, is not considered as an obstacle to the bank's immediate and unfettered access to the assets;
  - net assets of a fund which may be used to reduce future contributions, or , even more, to cover the deficit of another plan are deemed to entail immediate access.

It would be also useful for the Technical Standard to confirm that the condition provided for in Article 13 is the only ground on which the competent authority is authorised to rely to refuse its prior consent.

- It needs to be noted, finally, that, following amendments that have been made to IAS 19, the accounting treatment of defined benefit pension plans will change in a significant way.

IAS 19, as it stands today, provides entities with an option, i.e : either (i) to recognise all gains and losses when they occur, or (ii) to leave actuarial gains and losses unrecognised if they are within a "corridor" and to defer recognition of actuarial gains and losses outside the corridor. "The revised IAS 19 removes the second option: institutions will no longer be authorised to make use of the "corridor method" from 01.01.2013 onwards. As a result, all changes in defined benefit obligations will need to be reported as they occur: entities will be required to include the net cumulative unrecognised gains or losses in their financial statements.

The EBA should bear in mind that the removal of the pension corridor will have a huge impact on the capital adequacy of institutions in various Member States if the impact of the revised accounting treatment would be reflected in full in Equity already from day 1 (i.e. 01.01.2013). Because of the significant decline in the discount rate over the past year, financial institutions which have implemented IFRS and which are not already recognising actuarial gains and losses in Equity, may be faced with negative estimates. It would be essential for those institutions that the negative impact of the amendments to IAS 19 be mitigated by introducing transitional rules to make sure that the recognition in Equity of unamortised actuarial losses on pension obligations be spread over several years.

We believe that the text of the CRR proposals in the area of capital adequacy authorises the EBA to include transitional rules along these lines.

- Article 33, §1, (e), requires institutions to deduct defined benefit pension fund assets of the institution from Common Equity Tier 1;
- Article 451, §1, (a), states that, by way of derogation to Article 33, §1, during the period from 1 January 2013 to 31 December 2017, institutions shall deduct from Common Equity Tier 1 the applicable percentage specified in Article 458 of the amount required to be deducted pursuant to points (a) to (h) of Article 33, §1.

**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?**

As we will explain extensively below in our answer to Question 9, we do not understand the rationale underlying the proposals set out in Articles 15 to 17.

As such, the provisions are mostly clear. However, with regards to the assessment if the financial institution is subject to prudential requirements equivalent to those applied by institutions under the CRR (resp. Directive 2009/138/EC), we assume that the EBA (resp. the EIOPA) will publish a list of all countries that have similar prudential regimes in place.

Moreover, the proposed Articles 16 and 17 are not in line with Article 70 CRR: which states that “**Institutions shall not deduct** from any element of own funds **holdings** of a regulated financial entity within the meaning of paragraph 2 of Article 137(4) **that do not qualify as regulatory capital** of that entity.” Pursuant to Article 137, § 4, CRR, the definition of regulated financial entity also includes third country entities, inter alia insurance undertakings (Article 137, §4, (a), (iii), CRR). Contrary to these provisions, Articles 16 and 17 of the EBA's draft standards require the deduction of "(a) all instruments qualifying as capital under the company law applicable to the issuer; (b) any dated and undated subordinated instruments" - irrespective of whether they qualify as regulatory capital of that entity.

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

We believe that the proposal does not comply with the mandate which the CRR will confer to the EBA, insofar as it basically negates the “corresponding deduction approach” that is clearly outlined in its Articles 41 – 43, 53, 57, 63 and 67.

Indeed, by nature, most financial institutions (even those having their headquarters in the EU) will not be subject to requirements deemed equivalent to the CRR as the Regulation applies to

credit institutions only. As *per* the draft, any subordinated debt issued by such institutions will be deemed to be bearing the same risks as Common Equity Tier 1 instruments, even though it is much less risky – and consequently, much less rewarding. This will give EU banks incentives to restrain from investing into hybrids or subordinated debt of financial institutions or, worse, to move their investments to capital. This cannot have been the intention pursued by the EBA.

We believe that **to comply with the level 1 text, the corresponding deduction approach should be applied to all financial institutions**, irrespective of whether this institution is in fact subject to the CRR. At the same time, we share the EBA’s likely concern that, if instruments issued by financial institutions were to be classified according to the criteria set out in the CRR, (as will be the case for institutions) many instruments which bear risk that is akin to risk on a bank’s prudential instruments would be out of the scope of the deduction (for instance, it is quite unlikely that a financial institution not subject to CRR will issue hybrids with largely loss absorbing features that would make it compliant with CRR Additional Tier 1 criteria).

We suggest adopting “softer” criteria based on subordination, which would allow both the inclusion of the broad range of instruments referred to in Article 15 (2) of the draft in the scope of the deduction and full compliance with the corresponding deduction approach:

- Ordinary shares and all instruments which are the most junior issued by the financial institution should be deemed as equivalent to Common Equity Tier 1;
- Preference shares, when clearly less junior than ordinary shares, and deeply subordinated debt should be deemed as equivalent to Additional Tier 1;
- Subordinated debt, whether dated or not, should be deemed as equivalent to Tier 2.

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

To answer this question, one would need to examine the final text of the forthcoming Regulation.

**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?**

In principle, we agree on the types of incentives to redeem. The existence or non-existence of an incentive to redeem should be assessed at the time of issuance. In addition, we suggest that this assessment be carried out by the relevant competent authority.

The types of incentives to redeem should do not have features hindering recapitalisation, such as provisions requiring the issuer to compensate the investor if new instruments are issued at lower price during the specified time frame.

**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?**

Given the complexity of the question raised, we have subdivided our comments into the following sections: initial write-down; distributions; amounts available for write-ups; write-up mechanisms.

In most cases, we try to distinguish between two separate situations:

- (i) the situation in which the institution is able to restore its solvency without raising external Common Equity Tier 1;
- (ii) the situation in which, *while Additional Tier 1 instruments are written down*, the institution raises external equity to face its solvency issues.

Whilst we agree with the idea that in the second situation, the existence of Additional Tier 1 should not be detrimental to new shareholders (because this would lower the bank's capacity to attract them), we take the view that in the first situation, the fundamental hierarchy between shareholders and hybrid holders should be respected.

### Initial write-down

We would suggest that the final text would clarify that the following will be considered as "increase in equity that is eligible as Common Equity Tier 1 capital":

- a write-down of liabilities resulting in an increase in "other reserves" (but not capital);
- a write-down of equity-accounted hybrid instruments clearly stated in the audited accounts that results in the amount of "residual" (i.e. non hybrid) shareholders' equity being increased by the same amount.

The draft is not clear with respect to the write-down when the institution has issued instruments with different trigger levels. We suggest amending Article 20, §1, and, more particularly, inserting a subparagraph: (d): "*if instruments with different trigger levels are outstanding, the write-down described in point (a) shall apply first to those instruments with the highest trigger; instruments with a lower trigger will be written down according to point (a) only after such instruments have been fully written-off*".

Regarding the proposed timing, we consider that one month may be too short to assess the exact shortfall of Common Equity Tier 1: any attempt to do the exercise properly within such a short timeframe would in any event put too much pressure on scarce resources). We propose allowing institutions to use a conservative estimate of the shortfall instead.

### Distributions

Point 20 (3) (a) proposes that, for the write-down to be considered temporary, all payments shall be cancelled while the write-down is in effect, until the nominal amount of the instrument is fully reinstalled.

However, we fail to see why payments on AT1 instruments would be restricted while there is a write-down, given that distributions may be paid to “old” shareholders (there are no dividend stoppers or pushers included as in previous hybrids defined by CEBS, which paves the way for asynchrony in dividend and coupon payments). The proposal amounts to treating AT1 holders worse than CET1 holders.

We believe that the restrictions laid on distributions when capital buffers are not met, together with market pressure, will be sufficient safeguards against any undesirable distribution to Tier 1 holders. In addition, it is our understanding that coupons should only be paid on the non-written-down amount.

#### Amounts available for write-ups or distributions

Write-ups and distributions should not be based solely on profits but on any generation of Common Equity Tier 1, which can also include RWA reduction (e.g. via asset disposals, for instance through the performance of part of the institution’s recovery plan) or variation of reserves (e.g. if unrealised losses revert back to a higher value).

According to Article 20, §3, (e), the maximum amount to be attributed to the write-up of the instrument needs to be based on a percentage of the Additional Tier 1 amount before write-down and the total Tier 1 capital of the institution at each moment. Unfortunately, the percentage calculation is inconsistent because both variables - additional Tier 1 and Total Tier 1 - refer to different moments in time. Given the currently proposed procedure this would unduly discriminate AT1-holders. Therefore, we propose to delete Article 20 §3, (f). It effectively places holders of AT 1 instruments in an inferior position to holders CET 1 instruments, because holder of CET 1 instruments gain fully on consolidated reserves built up while there are restrictions on distributions imposed by the maximum distributable amount (MDA). Deletion of Article 20, §3, (f), would imply that holders of AT 1 instruments receive their pro rata share of profits in the form of write-ups during the write-down period. Such a pro rata based allocation of profits would not hinder recapitalization, as long as new capital injection by new shareholders would reduce the share of reserves attributed to AT1-write-ups.

We, therefore, believe that the amount to be attributed to the writing-up of the instrument should be based on the ratio of nominal amount of the AT 1 instrument and the Total Tier 1 capital immediately before the write-down plus the nominal amount of any Additional CET 1 instruments issued after the write down. But it needs to be assured that the build-up of reserves is not added to the denominator. Otherwise the write-down would be unnecessarily deferred or impeded, because any build-up of reserves during the write-down period would reduce the ratio in favor of holders of CET 1 instrument, which would place the holders of AT 1 instrument in an inferior position than holders of CET 1 instruments.

To elaborate on the example provided by EBA, profits (and other sources of surplus Common Equity Tier 1 generation) of preceding years “attributable” to Additional T1 holders should also

be available for write-ups. Indeed, as much as distributions may be made out of earnings from previous years, in the example provided shareholders essentially keep all of the 100 profit made in year 1 as they are incorporated into retained earnings and will eventually be distributed to them, while Additional Tier 1 holders will never have a claim on the 29 profit attributed to them (in other words, while AT1 coupons are non-cumulative, this is not the case of dividends). As a result, in year 2 the amount available for write-ups before MDA should be 54 (not 25).

### Write-up mechanisms

We see no reason for prohibiting other forms of write-ups than discretionary ones: such a prohibition would lead to serious legal and / or tax issues in some Member States. For instance, a clause that allows for discretionary write-ups while coupons are already fully discretionary, in compliance with the Regulation, might be viewed as *leonine* by some courts; as it would likely be challenged in a stress situation, it would only add to the difficulties experienced by the institution. Of course, permanent write-downs would not be an improvement in that respect. From a tax perspective, a write-down will result in the generation of taxable profit in some Member States; while it is extremely likely that tax losses will also be available as a result of the decrease in the Common Equity ratio leading to the breach of the trigger, a strict application of the Regulation will lead to a limitation in the initial recognition of the Additional Tier 1 instrument and its availability to absorb losses.

As long as AT1 instruments do not have any clauses that hinder a recapitalisation, formulas for write-ups (e.g. based on the amount of CET1 available for distributions to “old” Tier 1 holders versus “new” shareholders) should be acceptable.

Consequently, we would support that banks which find it desirable be allowed to include automatic write-up formulas in the clauses of their Additional Tier 1 instruments, at least in the first situation referred to in our introduction to our answer to the Question - i.e. when there is no external capital increase used to restore the solvency ratios. Such clauses could notably be drafted to ensure that any distributions on Common Equity Tier 1 instruments trigger a write-up up to the maximum amount attributable to Additional Tier 1.

We agree that this automatic write-up clause may be waived in case the institution raises external equity (situation (ii)), to avoid deterring new shareholders from participating in the rescue.

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

There is mounting evidence that the potential participation and appetite from the fixed income community in an Additional Tier 1 with conversion structure could be limited due to tier fund mandates and investment preferences. A loss absorbency requirement limited to equity conversion would either reduce the potential issuance amount due to a limited investors target or increase issuance costs reducing the efficiency of the financial sector. In this regard, Additional

Tier 1 issuance with write-down structure would pave the way for a feasible, deep and tradable Tier 1 market.

To provide an empirical evidence of the investors' appetite, the following table displays the structural preferences of the main Tier 1 and 2 debt investors in the US and EU.

| Investor                | Equity limitations? | Structural preferences   |
|-------------------------|---------------------|--|
| Fixed income 1          | Yes                 | Fixed income Investor 1 can buy both write-down and convertible structures, but would be bigger in a pure fixed income product that can go into more of its funds than equity linked structures. |
| Fixed income 2          | Yes                 | Fixed income Investor 2 funds have stated a strong preference for temporary write-down structures, however its smaller retail funds can take equity risk.  |
| Fixed income 3          | Yes                 | Fixed income Investor 3 can also buy both write-down and convertible structures, but has a preference for write-down whilst convertible structures remain outside the indices.                   |
| Fixed income 4          | Yes                 | Most of Investor 4's fixed income funds can hold write-down structures, but only a minority can hold equity linked structures due to their current investment mandates.                          |
| Private bank 1          | Yes                 | Private bank Investor 1 prefers write-down structures over equity conversion, due to the mandates of its funds.  |
| Private bank 2          | Yes                 | Private Bank Investor 2 does not think that equity conversion structures are appropriate for fixed income and their mandates does not allow such structures.                                     |
| Fixed income 5          | NO                  | Fixed income Investor 5 can take both write-down and convertible structures.   |
| Fixed income 6          | NO                  | Fixed income Investor 6 can take both write-down and convertible structures due to the wide range of mandates across its funds.  |
| Fixed income            | NO                  | Fixed income Investor 7 can hold both equity and write-down structures, but have fewer funds that can hold the equity linked variety and thus would be smaller.                                  |
| Private bank 3, 4 and 5 | NO                  | Some private banks provide a large proportion of the demand for contingent capital and will invest in both equity and conversion structures..  |
| Hedge Funds             | NO                  | Hedge funds have a preference in equity linked structures.   |

Knowing that write-down structures are necessary, we would like to highlight the central role of write-up clauses in the additional Tier 1 instruments.

- According to the forthcoming Regulation, the provisions governing the additional Tier 1 instruments require the principal amount of the instruments to be written down, or the instruments to be converted into Common Equity Tier 1 instruments, upon the occurrence of a trigger event (Common Equity Tier 1 ratio less than 5,125%).
- The root of the problem is that the trigger event could occur whether the institution is at resolution and liquidation, or at recovery. In a resolution process, loss-absorbency mechanisms seek to reduce tax-payer costs in a winding-up process, and debt instruments suffer a permanent loss. On contrary, in a recovery process, loss-absorbency mechanisms seek to restore capital levels in a going-concern basis. In case of recovery, if equity stock increases its value after the conversion, convertible Additional Tier 1 investors will recover part of their investments. On the other hand, permanent write-down Tier 1 investors will be at a disadvantage because they will not benefit from a stock rise. Therefore, if the bank capital ratios return above the level which had triggered the write-down, additional provisions governing the write-up of the principal amount should be included.
- In general, the inclusion of write-up clauses will put write-down Tier 1 debt on a level with convertible Tier 1 debt paving the way to wider Tier 1 issuance alternatives. If write-up clauses are not permitted, then write-down debt will be jeopardized and conversion will be the only issuance alternative for additional Tier 1.

To conclude: the “hierarchy of capital instruments” needs to be properly reflected. Hence, when the bank sufficiently recovers after a write-down and shows required revenues to healthily maintain the combined capital buffers, AT1 instruments should be brought in a position to fulfil regular payments swiftly. Equally, situations have to be avoided, that AT1 instruments after a write-up or in general do not receive any payments whilst lower ranking capital instruments (i.e. shares) receive dividends

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

- It would be helpful if Article 25, §1, - which addresses indirect holdings arising from index holdings - would start in clarifying how the concept of index“ is to be defined. Does it refer only to indices which are publicly disclosed? The second sentence - *“For the purpose of this Article, an index includes, but is not be limited to, index funds and indices of credit derivatives”* – creates confusion as indices of credit derivatives are rather unusual. We, therefore suggest, clarifying the issue by including a reference in §1 of the most obvious indices which are being mentioned in Article 25, §5, i.e. equity indices or bond indices.

Moreover, we wonder if referring to "indices of credit derivatives" makes much sense. It is difficult to understand why an investment in such indices (long position) would always be need to deducted from capital as an indirect or synthetic holding. We would expect that, for instance, a CDS that relates to bonds issued by a financial sector entity would not necessarily

result in an indirect/synthetic holding of instruments issued by that financial sector entity that has to be deducted from own funds - namely when such bonds do not qualify as Common Equity Tier 1, Additional Tier 1 or Tier 2 instruments.

Finally, the wording used in Article 25 , §5 - "*Depending on the nature of the index (equity index or bond index)*" - is probably confusing. Why , and to what extent, should the application depend on the nature of the index? One would assume that a corresponding deduction approach would need to apply in any case. Against this backdrop, we would like to suggest either deleting the first part of the sentence ("*depending on the nature of the index (equity index or bond index)*") or starting with the general principle and provide an explication subsequently on the different types of indices.

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

- We strongly believe that the Technical Standard should provide for an “exemption threshold” which we would like to suggest setting at 3% of an institution’s Total Capital. As a result, a complete deduction of the holding of the index would be applicable only (i) if step 1 and 2 of the EBA-approach are not feasible and (ii) the sum of all net long positions of those index holdings exceeds 3% of an institution’s Total Capital.

Additionally we suggest opting for an alternative treatment of index holdings so that potential long positions are included in the RWA calculation.

- We oppose the alternative, structure-based approach because it does not simplify the process of determining the indirect holding in an index. We suggest adopting an approach which draws inspiration from some investment trusts that currently calculate a quarterly average risk weight on their funds based on a look through approach. Such a method can be used for the RWA calculation of funds within the RWA-amounts of banks; in future potential calculations the relevant positions within the fund of e.g. bank-shares will be weighted with a risk weight of for example 1.250% and the result will be recognised in the calculated average. Such an approach is likely to overdraw the inherent risk, but would simplify workflows within the calculation.

**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 26 suggests that competent authorities, in their assessment of the nature of operationally burdensome situations, might take into account "*low net exposure to the capital of the relevant entity relative to the institution’s total own funds*". The difficulty is, however, that it is only possible to calculate the net exposure after having performed a complete look-through exercise. The proposal would therefore not provide for a solution.

### **Comment on the proposed Article 27**

Our understanding is that Article 73, §3, (a), CRR focusses on situations where an institution would like to replace an existing capital instrument with lower distributions (e.g. coupons) by a new instrument with higher distributions, resulting in a higher interest expense or distribution going forward. Obviously, in such a situation, institutions will consider the overall economic and regulatory validity of such an “exchange”.

The second sentence of Article 27 suggests that an assessment of the institution's profitability in stress situations be taken into account to judge the income capacity of an institution after the replacement of the instruments with own funds instruments. Where such a replacement results in an improvement of the capital situation, we do not believe it to be appropriate to consider stress situations. We therefore suggest introducing appropriate wording to reflect this.

### **Comment on the proposed Article 28**

The last sentence of paragraph 2 should be amended: “Sufficient certainty is deemed to exist in particular when a legal requirement for the institution exists to reduce or repurchase an own funds instrument.” To assume sufficient certainty would already exist at the time of public announcement of an intention to redeem would be far too early. The announcement of a buy back program and its maximum amount does not necessarily and not immediately mean that the capital will leave the institution.

### **Comment on the proposed Article 29**

Paragraph 1 should be amended to clarify that it applies only whenever an institution envisages calling, **redeeming early** or repurchasing Additional Tier 1 or Tier 2 instruments.

If no explicit reference is made to an **early** redemption, any redemption of a dated Tier 2 instrument at its maturity would need supervisory consent.

### **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)?**

We agree that the proposed thresholds are workable and in line with current practices. However, the proposed thresholds regarding instruments repurchased, for market making purposes (lower or equal to 3% of the outstanding, or 10% of, the excess of capital requirements) seem too restrictive. Our understanding is that it remains possible for competent authorities to set a predetermined amount of own funds instruments to be repurchased, or even to set lower levels

than those defined here. Against this backdrop, we see no harm in setting higher limits than those which are proposed in the consultation paper.

We note there is a typo in point 3 (a) of Article 29 (“3%” and “10%” are misplaced).

Finally, we would like to address some minor issues:

- In paragraph 1 of Article 29, the word „early“ should be inserted: “*The institution shall submit an application (...) before (...) calling, redeeming **early** or repurchasing Additional Tier 1 or Tier 2 instruments*”. If not, any redemption of a dated Tier 2 instrument at its maturity would require an application to be submitted.
- In paragraph 3, the method of calculation needs to be amended. More particularly, the reference made to “*the specific own funds requirement referred to in Article 100 of the CRD*” needs to be removed because a comparison to Pillar II-requirements which are most probably very volatile, is not workable.
- Paragraph 4 stipulates that the competent authorities may lower the limits referred to in paragraph 3. This amounts at providing that authority with discretionary powers, which we oppose against the backdrop of the Single Rulebook concept. The final version should, therefore, delete the words “*may lower the limits indicated in points (a) and (b) of paragraph 3 and*”. Furthermore, we ask for clarification that the authority would need to act in a diligent way when removing its prior consent to avoid defeating the institution’s reasonable expectations.
- Regarding paragraph 5, the cross-reference should be limited to the first sentence: “*5. The first sentence of paragraph 3 may also be applied where own funds instruments are passed on to employees (...)*”. A limitation of purchases for purposes of remuneration programs should be avoided. European Company Law already limits purchases in this context. Further requirements are not necessary and would, moreover, be counter-productive. The requirement to deduct equity compensation instruments for a relatively short period where the purpose of the share buy-back is clear would create perverse incentives contrary to the FSB and European objective of increasing the equity element of remuneration to allow for claw-back. Employees are mandatory investors in the bank’s equity and the capital position should not be impacted in this case.

### **Comments on the proposed Article 30**

We generally agree that institutions should provide the competent authority with the rationale of a reduction of own funds that they envisage and its impact. However,

- the content and the depth of that information should be proportionate to the level of the impact of such an action To always ask for a 3 year capital plan might be disproportionate.
- paragraph 3 should be transformed in an obligation for the competent authority as we fail to understand why an authority should be authorized to ask for information which is already available to it.

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

The limit seems acceptable. However, we believe that the supervisor should always be able to waive the 3-months requirement, even if circumstances are not "exceptional". In paragraph 3 the words "and under exceptional circumstances" should, therefore, be deleted.

**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)?**

Some of our member banks may provide input on this.

**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?**

The limitation for the application of the waiver from deduction of own funds amounting to 5 years should be deleted. In most cases 5 years are not sufficient to reorganise, restructure, integrate or wind-up a medium-sized or large bank.

In addition, the waiver should not be limited to situations where the institution has negotiated it prior to the rescue as such matters are typically not amongst those that are being dealt with in emergency situations.

**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)?**

We do not agree with the limit on the amount of other assets of an SPE set at 0.5% (or lower) of the average total assets of the SPE over the last 3 years as we believe it to be too low. In general "other assets" of SPEs will only consist of assets that are necessary for operational business purposes or to run the business. Especially smaller SPE structures might have difficulties staying within the limit of 0.5% for those assets.

It would be useful to clarify that when instruments are issued out of an SPE that complies with the conditions of Article 78 CRR they are treated as if they had been issued by the bank, as in the Basel text (i.e. no computation of surplus minority interests).

## COMMENTS ON THE ANNEXES

### 1. Comments on the explanations provided on page 53

- a. It would be helpful if the EBA would provide details on the contents of cell E6 '5.125'? The answer can only be found by deduction, but it would be better if it were made more explicit.
- b. The calculation as a whole is quite difficult to understand.
- c. There is a lack of clarity on how the capital conservation mechanism works: The Basel III text of December 2010 explains that an institution needs to calculate the capital buffer and then, based on the quartile the capital ratio falls in, can be limited in its distributions. This implies the capital ratio ex ante to be decisive here.

An example (assuming a countercyclical buffer requirement and a systemic buffer requirement of 0% for simplicity's sake):

RWAs are 1000

Company makes a profit of 10

- If the institution's CET1 capital is 69, the institution falls in the upper quartile of the  $(4\frac{1}{2}\%+2\frac{1}{2}\%$  capital conservation buffer and can distribute 60%, or 6, to its shareholders.
  - If the institution's CET1 capital is 71, article 131.1 of the CRD4 would indicate that the institution can distribute only 1 to its shareholders. This seems awkward..
- d. A related issue is the following:

The CET1 equity at the end of year 1 is 641 (cell B27).

RWAs at the end of year 1 are 12500 (cell B36).

Hence the CET1 ratio is 5.128% and this institution falls in the second quartile, be it with a narrow squeak. The Maximum Distributable Amount according to Article 131.4.(b) of the CRD4 is 20%. We therefore believe that cell B25 of the Annex should read 20 instead of 0.

### 2. Comments on the explanations provided on page 58:

What is missing in the consultation document is a planning / time table. We understand that the responses to the consultation paper will be considered, but what will happen next? When can we expect the final technical guidelines? What time-frame should banks reserve for testing and implementation and when would the implementation date be? Does the implementation of the requirements mean that the then outdated requirements will be abolished?