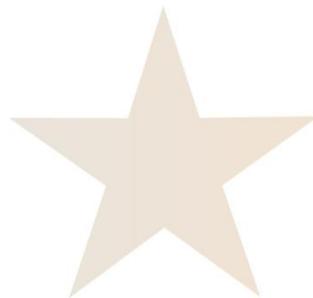


EBA FINAL draft regulatory technical standards

on own funds [Part 3] as per Articles 36(2), 73(7) and 84(4) of Regulation (EU) No 575/2013 (Capital Requirements Regulation- CRR)



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Table of contents

| | | |
|-----|--|----|
| 1. | Executive summary | 3 |
| 2. | Background and rationale | 4 |
| 3. | Draft regulatory technical standards on Own Funds under Articles 36(2), 73(7) and 84(4) of the draft Capital Requirements Regulation (CRR) | 7 |
| 4. | Accompanying documents | 22 |
| 4.1 | Draft cost - benefit analysis / impact assessment | 22 |
| 4.2 | Views of the Banking Stakeholder Group (BSG) | 26 |
| 4.3 | Feedback on the public consultation and on the opinion of the BSG | 27 |

1. Executive summary

Regulation (EU) No 575/2013 (Capital Requirements Regulation – CRR) sets out requirements concerning own funds which shall apply from 1 January 2014, and mandates the EBA under Articles 36(2), 73(7) and 84(4) of the CRR to prepare draft regulatory technical standards (RTS) on these requirements. These articles cover the deduction of indirect and synthetic holdings, conditions for qualifying as broad market indices, and the treatment of minority interests, all for the purposes of calculating own funds.

The objectives of these draft RTS are:

- ▶ On the deduction of indirect and synthetic holdings: to achieve greater harmonisation and increased conservatism in the way the deductions of investments in financial sector entities and own capital instruments are applied.
- ▶ On broad market indices: to put forward criteria for broad market indices so as to avoid that the interest rate/dividend paid by institutions on floating rate capital instruments increase when the credit standing of the institution decreases (credit sensitive dividend features).
- ▶ On minority interests: to harmonise the calculation of minority interests for inclusion in regulatory capital.

These draft RTS result from additional mandates granted to the EBA in the final version of the CRR and constitute the third part of the final draft RTS on own funds. The EBA issued parts one and two earlier in the year. These were submitted to the EU Commission and then published on the EBA website on 26 July 2013. They are expected to be adopted in the form of a Commission regulation shortly. To support the completion of the EU Single Rule Book for institutions in the area of own funds, all of these draft RTS are to be presented as one single draft regulation. The legal text of the draft RTS that follows is therefore presented as addendum to that draft regulation and should be read in conjunction with the text of those previously published draft RTS.

These draft RTS will be part of the Single Rule Book to enhance regulatory harmonisation in Europe and improve the quality of bank capital.

The corrigendum to Regulation (EU) 575/2013 published on 30 November 2013 modified the list of entities considered as financial sector entities; in particular, MAHC (Mixed Activity Holding Companies) are now excluded from that list, meaning that direct holdings of own funds instruments in MAHC would not be in the scope of the deductions from the own funds of an institution. While the EBA had to operate on the basis of the current CRR text pending before publication of the corrigendum, it will keep working on this aspect in order to address in particular the issue of potential double counting of capital stemming from financial sector entities that are subsidiaries of MAHC.

2. Background and rationale

Draft RTS on own funds – part 3

On 26 June 2013, the revised texts of the Capital requirements Directive (CRD) and Capital Requirements Regulation (CRR) were published in the Official Journal of the EU. These apply the internationally agreed standards adopted by the Basel Committee for Banking Supervision or BCBS (known as the 'Basel III framework') in the EU.

The EBA has developed these draft RTS in accordance with the mandate contained in Articles 36(2), 73(7) and 84(4) of the CRR.

The status of RTS under EU law

These draft RTS are produced in accordance with Article 10 of the EBA Regulation¹. Pursuant to Article 10(4) of the EBA Regulation, RTS shall be adopted by means of a regulation or decision.

Under 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 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 insofar as this is expressly required by any particular regulation.

Shaping these rules in the form of a regulation would ensure a level-playing field by preventing divergent national requirements and it would ease the cross-border provision of services. As things currently stand, a financial institution that wishes to operate in another Member State has to apply different sets of rules to do so.

Background and regulatory approach followed in the draft RTS

Until the date of application of the CRR (1 January 2014), the applicable regulatory framework for own funds is derived from Directives 2006/48/EC and 2006/49/EC, in particular Articles 56 to 67, as enacted in national law by each Member State. This CRD was complemented by the publication of two sets of guidelines by the (then) Committee of European Banking Supervisors (CEBS), the predecessor of the EBA. The first set of guidelines, published in December 2009, relates to hybrid capital instruments². The second set of guidelines, published in June 2010, refers to elements of Article 57(a) of Directive 2006/48/EC³.

¹ 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.

² <http://www.eba.europa.eu/CMSPages/GetFile.aspx?nodeguid=97f3cd8f-855c-40de-a98b-b923e8eaa4ad>

³ http://www.eba.europa.eu/documents/Publications/Standards---Guidelines/2010/Guidelines_article57a/Guidelines_article57a.aspx

In December 2010, the Basel Committee on Banking Supervision (BCBS) published its 'global regulatory framework for more resilient banks and banking systems' to address the lessons of the financial crisis. The CRR provisions related to own funds translate these BCBS proposals into EU law. Both reforms raise the issues of the quality and the quantity of the regulatory capital base.

These draft RTS constitute part 3 of the own funds draft RTS. They are based on Articles 36(2), 73(7) and 84(4) of the CRR. The draft RTS complement those submitted to the EU Commission and published on the EBA website on 26 July 2013, in particular in terms of provisions related to deductions from Common Equity Tier 1 (CET1).

In accordance with those Articles, the EBA is required to develop these draft RTS by 28 July 2013. A change in the submission date to 1 January 2014 was requested by EBA on 10 July 2013 and was accepted by the Commission.

All draft RTS related to own funds requirements are intended to be put forward as one integrated draft regulation. The rationale for this approach is to support the completion of the EU Single Rule Book for institutions in the area of own funds. It is useful to group these regulations together in one legal act to facilitate a comprehensive view, improve understanding and provide direct access to them by legal or natural persons subject to the obligations laid down therein. With that in mind, the legal text of the draft RTS that follows is presented as addendum to that draft regulation and should be read in conjunction with the text of those draft RTS.

Under Article 36(2) of the CRR, the EBA shall develop draft regulatory technical standards to specify the application of the deductions referred to in points (a), (c), (e), (f), (h), (i) and (l) of paragraph 1 of that same Article; related deductions contained in points (a), (c), (d) and (f) of Article 56; and points (a), (c) and (d) of Article 66. The EBA has already published draft RTS specifying the application of the deductions referred to in points (a), (c), (e) and (l), since this mandate was already included in the original proposal from the EU Commission published in July 2011. The EBA is now publishing the RTS relating to the extended mandate, that is, the application of deductions referred to in points (f), (h), (i) of paragraph 1 of Article 36; related deductions contained in points (a), (c), (d) and (f) of Article 56; and points (a), (c) and (d) of Article 66.

First, the provisions included in these draft RTS explain what intermediate entities mean for the purpose of deducting holdings in financial sector entities held indirectly through intermediate entities (such as holdings in mutual funds, investment funds, pension funds etc which hold capital instruments of financial sector entities or special purpose entities). The draft provisions also detail the different investments to be considered as synthetic holdings according to Article 4(126) of the CRR (such as investments in total return swaps, guarantees or credit protection or different types of options). The draft RTS also detail the amount to be deducted from CET1 items in each case.

The draft RTS also detail the calculation to be undertaken by institutions to determine the percentage held indirectly in a financial sector entity, meaning in situations where one or several intermediate entities stand between the institution and the financial sector entity. The draft RTS provide institutions with the methods to be used to calculate the final percentage of an indirect holding in a financial sector entity. The draft RTS also detail how indirect holdings should be taken into account when calculating

the percentage indicated in Article 43(a) of the CRR to determine whether the holding is below or above the threshold for significant investments in a financial sector entity.

Secondly, on the basis of the mandate in Article 73(7) of the CRR, the draft RTS focus on market indices used as references for the remuneration on Additional Tier 1 (AT1) or Tier 2 (T2) instruments. In relation to this, the draft RTS contain several criteria that need to be fulfilled for indices to be considered as broad market indices. The EBA does not address in these draft RTS issues related to the governance of market indices, which are beyond its mandate and which will form part of other pieces of legislation currently under discussion in the EU. These draft RTS focus on correlation issues only, meaning that indices shall be sufficiently broad to ensure that the institution's own credit standing is not driving the rates set by that index. An interest rate index shall be deemed sufficiently broad if there are at least six participants or if there are at least four participants who are together representative of the related market. Equity indices can be used as a reference if they are sufficiently diversified.

Thirdly, the draft RTS provide detail about the calculation of minority interests as specified in Article 84(4) of the CRR. Pursuant to this Article, the EBA shall develop draft regulatory technical standards to specify the sub-consolidation calculation required in accordance with Articles 84(2), 85 and 87. For the purpose of these RTS, the EBA has developed several conditions to be met by institutions.

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3. Draft regulatory technical standards on Own Funds under Articles 36(2), 73(7) and 84(4) of the draft Capital Requirements Regulation (CRR)



EUROPEAN COMMISSION

Brussels, **XXX**
[...] (2012) **XXX** draft

COMMISSION DELEGATED REGULATION (EU) No .../..

of **XXX**

[...]

COMMISSION DELEGATED REGULATION (EU) No .../2012

of XX month 2012

supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council 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 (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012⁴, and in particular third subparagraph of Article 36(2), third subparagraph of Article 73(7) and third subparagraph of Article 84(4) thereof,

Whereas:

(1) In order to avoid regulatory arbitrage and ensure a harmonised application of the capital requirements rules in the EU, it is important to ensure that there is a uniform approach concerning the deduction from own funds of certain items like indirect and synthetic holdings in own own funds instruments and indirect and synthetic holdings in other financial sector entities.

(2) Given that Regulation (EU) No 575/2013 already provides rules for direct holdings of an institution's own funds instruments by the institution itself and direct holdings of own funds instruments of other financial sector entities, this Regulation should establish rules for the deduction from own funds of holdings that relate to indirect and synthetic holdings of such instruments by the institution itself or in other financial sector entities.

(3) The treatment of indirect holdings arising from index holdings is covered by Article 76 of Regulation (EU) No 575/2013 and by Articles 25 and 26 of Regulation xx/xxx [*OF part 1/2-numbering to be checked with final version of that 'RTS on own funds part one'*]. Therefore, this Regulation should only cover indirect and synthetic holdings arising in the context of points (f), (h) and (i) of Article 36(1), points (a), (c), (d) and (f) of Article 56, and points (a), (c) and (d) of Article 66 of Regulation (EU) No 575/2013.

(4) Specifying the application of the deductions referred to in points (f) (h) and (i) of Article 36 of Regulation (EU) 575/2013 entails, besides the identification of exposures that are indirect and synthetic holdings arising in the context of those articles, also the establishment of detailed calculation methods of the amounts that result from such holdings and which should be deducted. Therefore, it is necessary for rules specifying the application of those deductions to also specify how the calculation referred to in Article 43 of that Regulation applies in the context of indirect and synthetic holdings.

⁴ OJ L 176, 27.6.2013, p. 1.

(5) Where an institution's own credit standing drives the rates set by market indices which are also used as a reference for the remuneration of Additional Tier 1 and Tier 2 instruments of the institution, prudential concerns arise, relating to the correlation between the distributions on the instrument and the credit standing of the institution. The number and the diversity of institutions in the panel should be high enough to adequately reflect the activities in the related market. Therefore, if an institution issues an Additional Tier 1 or Tier 2 instrument with a floating rate or a fixed rate that will revert to a floating rate, the rate that it pays on that instrument should not increase when the firm's credit standing declines. Therefore, where the rate is linked to an index, the index should be sufficiently 'broad' to ensure that the institution's credit standing is not driving the rates set by that index. The distinction here is between correlation due to the entire sector suffering stress and affecting the benchmark rate, and correlation due to one institution's credit standing affecting the benchmark rate.

(6) The calculation of minority interests at the consolidated level and subconsolidated level should be consistent. Therefore, the eligible minority interests of a subsidiary that is itself a parent undertaking of a financial sector entity should be the amount that results, for the parent institution of that subsidiary, when the parent institution applies the prudential consolidation referred to in Part One, Title Two of Regulation (EU) No 575/2013.

(7) Given the similar nature of the deductions covered by Articles 84, 85 and 87 of Regulation (EU) No 575/2013, the same provisions for the calculation of eligible minority interests should apply to all of these cases.

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

(9) The European Banking Authority has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits 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:

Article 1

Amendments to Regulation xx/xxx [OF part one and two]

Regulation (EU) No xx/xxxx [OF part one and two] is amended as follows:

1. The following Articles 15a to 15i are inserted after Article 15 [numbering to be checked with final version of 'RTS on own funds part one and two']:

“Article 15a-

Indirect holdings for the purposes of Article 36(1) (f),(h) and (i) of Regulation (EU) No 575/2013

1. Indirect holdings of capital instruments pursuant to points (f), (h) and (i) of Article 36(1) of Regulation (EU) No 575/2013, shall include any exposure, including senior exposures, to an intermediate entity that has, itself, an exposure to Common Equity Tier 1 instruments issued by the institution or by a financial sector entity where, in the event that the Common Equity Tier 1 instruments issued by the institution or by the financial sector entity were permanently written

off, the loss that the institution would incur as a result would not be materially different from the loss the institution would incur from a direct holding of those Common Equity Tier 1 instruments issued by the institution or by the financial sector entity.

2. For the purposes of paragraph 1, intermediate entities shall be entities that fulfil both of the following conditions:

(a) they are entities other than:

- (i) institutions, and insurance and reinsurance undertakings;
- (ii) mixed activity holding companies;
- (iii) financial sector entities in the meaning of article 4 of Regulation (EU) No 575/2013 that are subject to prudential supervision;

(b) they include:

- (i) mutual funds, investment funds, pension funds, index funds or securitisation special purpose entities that hold capital instruments of financial sector entities;
- (ii) defined benefit pension funds that hold capital instruments of financial sector entities, where the institution is supporting the investment risk and where the defined benefit pension fund is not independent from its sponsoring institution;
- (iii) entities, other than undertakings that are, by virtue of applicable national law, subject to the requirements of Regulation (EU) No 575/2013 and Directive 2013/36/EU when they hold capital instruments of financial sector entities, and for which one of the following conditions apply:

- (1) these entities are directly or indirectly under the control or under significant influence of one of the following:

- the institution or its subsidiaries;

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- the parent undertaking of the institution or the subsidiaries of that parent undertaking;
 - the parent financial holding company of the institution or the subsidiaries of that parent financial holding company;
 - the parent mixed activity holding company of the institution or the subsidiaries of the parent mixed activity holding company;
 - the parent mixed financial holding company of the institution or the subsidiaries of the parent mixed financial holding company;
- (2) these entities are jointly, directly or indirectly, under the control or under significant influence of one institution, several institutions, or a network of institutions, which are members of the same institutional protection scheme, or of the institutional protection scheme or the network of institutions affiliated to a central body that are not organized as a group to which the institution belongs;
- (3) These entities are special purpose entities or entities other than institutions or entities that are, by virtue of applicable national law, subject to the requirements of Regulation (EU) No 575/2013 and Directive 2013/36/EU and whose activity is to hold financial instruments issued by financial sector entities.
- (iv) Any entity that the competent authority considers to be used with the intention of circumventing the rules relating to the deduction of indirect and synthetic holdings.
3. For the purposes of point (ii) of paragraph 2(b), a defined benefit pension shall be deemed to be independent from its sponsoring institution where all of the following conditions are met:
- (a) The defined benefit pension fund is legally separate from the sponsoring institution and its governance is independent;
 - (b) The constitutional documentation, including any articles of association, bye-laws or rules of the defined pension fund

have been approved by an independent regulator or are established in the applicable national law of the relevant Member State;

- (c) The trustees or administrators of the defined pension fund have an obligation under applicable national law to act impartially in the best interests of the scheme beneficiaries instead of those of the sponsor, to manage assets of the defined pension fund prudently and to conform to the restrictions set out in the constitutional documentation or statutory or regulatory framework described in point (b);
- (d) The constitutional documentation or statutory or regulatory framework described in point (b) include restrictions on investments that the defined pension scheme can make in own funds instruments issued by the sponsoring institution.

Any holding of own funds instruments of the sponsoring institution held by the defined benefit pension fund shall be treated as an indirect holding of own capital instruments by the sponsoring institution. The amount to be deducted from the own funds of the sponsoring institutions shall be calculated in accordance with Article 15c.

Article 15b-

Synthetic holdings for the purposes of Article 36(1) (f),(h) and (i) of Regulation (EU) No 575/2013

Synthetic holdings of capital instruments pursuant to points (f), (h) and (i) of Article 36(1) of Regulation (EU) No 575/2013 shall include the following forms:

- (a) investments in total return swaps on a capital instrument of a financial sector entity;
- (b) guarantees or credit protection provided to a third party in respect of the third party's investments in a capital instrument of a financial sector entity;
- (c) call options purchased by the institution on a capital instrument of a financial sector entity;
- (d) put options sold by the institution on a capital instrument of a financial sector entity or any other actual or contingent contractual obligation of the institution to purchase its own capital instruments,;
- (e) investments in forward purchase agreements on a capital instrument of a financial sector entity.

Article 15c-

Calculation of indirect holdings for the purposes of points (f),(h) and (i) of Article 36(1) of Regulation (EU) No 575/2013

The amount of indirect holdings to be deducted from Common Equity Tier 1 items as required by points (f), (h) and (i) of Article 36 (1) of Regulation (EU) No 575/2013 shall be calculated in one of the following ways:

- (a) according to the default approach of Article 15d;
- (b) where the method described in Article 15d is deemed to be operationally burdensome by the institution to the satisfaction of the competent authority, according to the structure-based approach described in Article 15e. This structure-based approach shall nevertheless not be used by institutions for estimating these deductions in relation to investments in intermediate entities referred to in points (1) and (2) of Article 15a(2)(b)(iii).

Article 15d-

Default approach for the calculation of indirect holdings for the purposes of points (f),(h) and (i) of Article 36(1) of Regulation (EU) No 575/2013

1. Under the default approach, the amount of indirect holdings to be deducted as required by points (f), (h) and (i) of Article 36(1) of Regulation (EU) No 575/2013 shall be calculated according to the following:
 - (a) where the exposures of all investors in this intermediate entity rank *pari passu*, it shall be equal to the percentage of funding multiplied by the amount of Common Equity Tier 1 instruments held by the intermediate entity in the financial sector entity or;
 - (b) where the exposures of all investors in this intermediate entity do not rank *pari passu*, it shall be equal to the percentage of funding multiplied with the lower between the amounts described in (i) and (ii):
 - (i) the amount of Common Equity Tier 1 instruments held by the intermediate entity in the financial sector entity;
 - (ii) the institution's exposure to the intermediate entity together with all other funding provided to this intermediate entity that rank *pari passu* with the institution's exposure.

The amount to be deducted from own funds shall not be higher than the total funding provided by the institution to the intermediate entity and the amount of own funds instruments held by the intermediate entity in the financial sector entity.

2. The calculation in paragraph 1(b) shall be made for each tranche of funding that ranks *pari passu* with the funding provided by the institution.
3. The percentage of funding for the purposes of paragraph 1 shall be the institution's exposure divided by the sum of the institution's exposure to the intermediate entity and all other funding provided to this intermediate entity that ranks *pari passu* with the institution's exposure.
4. The calculation of paragraph 1 shall be made separately for each holding in a financial sector entity held by intermediate entities.
5. Where investments in Common Equity Tier 1 instruments of a financial sector entity are held indirectly through subsequent or several intermediate entities, the percentage of funding in paragraph 1 shall be determined by dividing the amount referred to in point (a) by the amount referred to in point (b):
 - (a) the result of the multiplication of amounts of funding provided by the institution to intermediate entities, by the amounts of funding provided by these intermediate entities to subsequent intermediate entities, and by amounts of funding provided by these subsequent intermediate entities to the financial sector entity.
 - (b) the result of the multiplication of amounts of capital instruments or other instruments as relevant, issued by each intermediate entity
6. This amount referred to in paragraph 5 shall be calculated separately for each holding in a financial sector entity held by intermediate entities and for each tranche of funding that ranks *pari passu* with the funding provided by the institution and the subsequent intermediate entities.

*Article 15e-
Structure-based approach for the calculation of indirect holdings for the
purposes of Article 36(1) (f),(h) and (i) of Regulation (EU) No 575/2013*

1. Under the structure-based approach, the amount to be deducted from Common Equity Tier 1 items referred to in point (f) of Article 36(1) of Regulation (EU) No 575/2013 shall be equal to the percentage of funding, as defined in paragraph 3 of Article 15d multiplied by the amount of Common Equity Tier 1 instruments held by the intermediate entity in the institution.
2. The amount to be deducted from Common Equity Tier 1 items referred to in points (h) and (i) of Article 36(1) of Regulation (EU) No 575/2013 shall be equal to the percentage of funding, as defined in paragraph 3 of Article 15d multiplied by the aggregate amount of Common Equity Tier 1 instruments held by the intermediate entity in financial sector entities.
3. For the purposes of paragraphs 1 and 2, an institution shall calculate separately the amount that the intermediate entity holds in Common Equity Tier 1 instruments of the institution and the amount that the intermediate entity holds in Common Equity Tier 1 instruments of other financial sector entities on an aggregate basis.
4. The institution shall consider the amount relating to holdings in Common Equity Tier 1 instruments of those financial entities as a significant investment referred to in Article 43 of Regulation (EU) No 575/2013 and shall deduct the amount in accordance with point (i) of Article 33(1) of that Regulation .
5. Where investments in Common Equity Tier 1 instruments are held indirectly through subsequent or several intermediate entities, paragraphs 5 and 6 of Article 15d shall apply.
6. Where an institution is not able to identify the aggregate amounts that the intermediate entity holds in Common Equity Tier 1 instruments of the institution or in Common Equity Tier 1 instruments of other financial sector entities, the institution shall estimate those amounts by using the maximum amounts that the intermediate entity is able to hold on the basis of their investment mandates.
7. When the institution is not able to determine, on the basis of the investment mandate, the maximum amount that the intermediate entity holds in Common Equity Tier 1 instruments of the institution or in Common Equity Tier 1 instruments of other financial sector entities, the institution shall treat the amounts of indirect funding that it holds

in the intermediate entity as an investment in its own Common Equity Tier 1 instruments and shall deduct them in accordance with point (f) of Article 36(1) of Regulation (EU) No 575/2013.

8. By way of derogation from Paragraph 7, the institution shall treat the amounts of indirect funding that it holds in the intermediate entity as a non-significant investment and shall deduct them in accordance with point (h) of Article 36(1) of Regulation (EU) No 575/2013, where all of the following conditions are met:
 - (a) the amounts of funding are less than 0.25% of the institution's Common Equity Tier 1 capital;
 - (b) the amounts of funding are less than €10mn;
 - (c) the institution cannot reasonably determine the amounts of its own Common Equity Tier 1 instruments that the intermediate entity holds.
9. Where indirect funds fall under Article 132 of Regulation (EU) No 575/2013, the institution may rely on the third parties identified in Article 132(5) of that Regulation, and under the conditions set by that Article, to calculate and report the aggregate amounts referred to in paragraph 6.

Article 15f-

Calculation of synthetic holdings for the purposes of Article 36(1) (f),(h) and (i) of Regulation (EU) No 575/2013

1. The amount of synthetic holdings to be deducted from Common Equity Tier 1 items as required by points (f), (h) and (i) of Article 33(1) of Regulation (EU) No 575/2013 shall be:
 - (a) for holdings in the trading book:
 - (i) where these are options, the delta equivalent amount of the relevant instruments calculated in accordance with Title IV of Regulation (EU) 575/2013;
 - (ii) where these are any other synthetic holdings, the nominal or notional amount.
 - (b) for holdings in the banking book:
 - (i) where these are call options, the current market value;
 - (ii) where these are any other synthetic holdings, the nominal or notional amount.

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2. Synthetic holdings referred to in paragraph 1 shall be deducted from the date of signature of the contract between the institution and the counterparty.

Article 15g-

Calculation of significant investments for the purposes of Article 36(1) (i) of Regulation (EU) No 575/2013

1. For the purposes of Article 36 (1)(i) of Regulation (EU) No 575/2013, in order to assess whether an institution owns more than 10% of the Common Equity Tier 1 instruments issued by a financial sector entity, according to point (a) of Article 43 of that Regulation (EU), institutions shall sum the amounts of their gross long positions in direct holdings, as well as indirect holdings of Common Equity Tier 1 instruments of this financial sector entity referred to in points (iii) and (iv) of Article 15a(2)(b).
2. Indirect and synthetic holdings shall be taken into account by the competent authority in order to assess whether the conditions in points (b) and (c) of Article 43 of Regulation (EU) No 575/2013 are met.

Article 15h-

Holdings of Additional Tier 1 and Tier 2

1. The methodology referred to in Articles 15a to 15f shall apply by analogy to Additional Tier 1 holdings for the purposes of points (a), (c), (d) and (f) of Article 56 of Regulation (EU) No 575/2013, and to Tier 2 holdings for the purposes of points (a), (c) and (d) of Article 66 of that Regulation, where references to Common Equity Tier 1 shall be read as references to Additional Tier 1 or Tier 2.
2. For the purposes of Article 15a, where the intermediate entity holds Common Equity Tier 1 instruments of the institution, those shall be deducted first.

Where this deduction is less than the total funding provided by the institution to the intermediate entity, other holdings of Common Equity Tier 1 shall then be deducted.

Where the intermediate entity holds Common Equity Tier 1 instruments, Additional Tier 1 instruments and Tier 2 instruments of financial sector entities, the Common Equity Tier 1 instruments shall be deducted first, the Additional Tier 1 instruments shall be deducted second, and the Tier 2 instruments last.

*Article 15i-
Goodwill*

For the application of deductions referred to in point (h) of Article 36(1) of Regulation (EU) No 575/2013, institutions need not identify goodwill separately when determining the applicable amount to be deducted according to Article 43 of that Regulation .”

2. The following Article 24b shall be inserted after Article 24:

*“Article 24b
Distribution on own funds instruments – broad market indices*

1. An interest rate index shall be deemed to be a broad market index if it fulfils all of the following conditions:
 - (a) it is used to set interbank lending rates in one or more currencies;
 - (b) it is used as a reference rate for floating rate debt issued by the institution in the same currency, where applicable;
 - (c) it is calculated as an average rate by a body independent of the institutions that are contributing to the index (‘panel’);
 - (d) each of the rates set under the index is based on quotes submitted by a panel of institutions active in that interbank market;
 - (e) the composition of the panel referred to in point (c) ensures a sufficient level of representativeness of institutions present in the Member State.
2. For the purposes of point (e) of paragraph 1, a sufficient level of representativeness shall be deemed to be achieved in either of the following cases:
 - (a) where the panel referred to in point (c) of paragraph 1 includes at least 6 different contributors before any discount of quotes is applied for the purposes of setting the rate;
 - (b) where, in the absence of the condition of point (a), both of the following conditions are met:

(i) the panel referred to in point (c) of paragraph 1 includes at least 4 different contributors before any discount of quotes is applied for the purposes of setting the rate;

(ii) the contributors to the panel referred to in point (c) of paragraph 1 represent at least 60% of the related market.

3. The related market shall be the sum of assets and liabilities of the effective contributors to the panel in the domestic currency divided by the sum of assets and liabilities in the domestic currency of credit institutions in the relevant Member State, including branches established in the Member State, and money market funds in the relevant Member State. A stock index shall be deemed to be a broad market index where it is appropriately diversified in accordance with Article 344 of Regulation (EU) No 575/2013.”

3. The following Article 34b shall be inserted after Article 34:

“Article 34b

Minority interests included in consolidated Common Equity Tier 1 capital

1. For the purpose of specifying the sub-consolidation calculation required in accordance with paragraph 2 of Article 84 and Articles 85 and 87 of Regulation (EU) No 575/2013, the qualifying minority interests of a subsidiary referred to in Article 81 that is itself a parent undertaking of at least a financial sector entity shall be calculated as described in paragraphs 2 to 4.
2. Where a competent authority has exercised the discretion referred to in Paragraph 1 of Article 9 of Regulation (EU) No 575/2013, the calculation to be undertaken under paragraphs 3 and 4 shall be made on the basis of the situation of the institution as if the discretion had not been exercised.
3. Where the subsidiary complies with the provisions of Part Three of Regulation (EU) No 575/2013 on the basis of its consolidated situation:
 - (a) the Common Equity Tier 1 capital of that subsidiary on its consolidated basis referred to in point (a) of Article 84(1) of that Regulation shall include the eligible minority interests that arise from its own subsidiaries calculated pursuant to Article 84 and the provisions laid down in this Regulation, and points (b) and (c) below;

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- (b) for the purpose of the sub-consolidation calculation the amount of Common Equity Tier 1 capital required according to point (i) of Article 84(1)(a) of that Regulation, shall be the amount required to meet the Common Equity Tier 1 requirements of that subsidiary at the level of its consolidated situation calculated in accordance with point (a) of Article 84(1) of that Regulation. The specific own funds requirements referred to in Article 104 of Directive 2013/36/EU are the ones set by the competent authority of the subsidiary;
- (c) the amount of consolidated Common Equity Tier 1 capital required, according to point (ii) of Article 84(1)(a) of that Regulation, shall be the contribution of the subsidiary on the basis of its consolidated situation to the Common Equity Tier 1 own funds requirements of the institution for which the eligible minority interests are calculated on a consolidated basis. For the purpose of calculating the contribution, all intra-group transactions between undertakings included in the prudential scope of consolidation of the institution shall be eliminated.
4. In order to perform the consolidation referred to in point (c) of paragraph 3, the subsidiary shall not include capital requirements arising from its undertakings which are not included in the prudential scope of consolidation of the institution for which the eligible minority interests are calculated.
5. Where the waiver referred to in paragraph 3 of Article 84 of Regulation (EU) No 575/2013 applies to a subsidiary, any parent undertaking of the subsidiary benefiting from the waiver may include in its Common Equity Tier 1 capital minority interests arising from subsidiaries of the subsidiary itself benefiting from the waiver, provided that the calculations foreseen in paragraph 1 of Article 84 of that Regulation and in this Regulation [*reference is to the OF 1/2*] have been made for each of those subsidiaries.
6. The methodology followed in paragraphs 2 to 4 shall also apply by analogy for the calculation of the amount of qualifying Tier 1 instruments under Article 85 of Regulation (EU) No 575/2013 and the amount of qualifying own funds under Article 87 of that Regulation, where references to Common Equity Tier 1 shall be read as references to Additional Tier 1 or Tier 2.

Article 2
Entry into force

This Regulation shall enter into force on the twentieth 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]

4. Accompanying documents

4.1 Draft cost - benefit analysis / impact assessment

4.1.1 Introduction

As per Article 10(1) of the EBA Regulation (Regulation (EU) No 1093/2010), any draft implementing technical standards/regulatory technical standards/guidelines developed by the EBA – when submitted to the EU Commission for adoption - should be accompanied by an Impact Assessment (IA) analysis of ‘the potential related costs and benefits’. This should provide the reader with the problem definition, the options examined to deal with this problem and the potential impact thereof.

4.1.2 Problem definition

Issues identified by the European Commission (EC) regarding own funds

Having taken into account:

1. the **general objectives** of financial stability and depositor protection;
2. the relevant following **problem drivers** identified by the European Commission:⁵
 - (i) certain capital instruments did not fulfil loss absorption, permanence and flexibility of payments criteria;
 - (ii) regulatory adjustments were not being applied to the relevant layer of an institution’s regulatory capital;
 - (iii) regulatory adjustments were not harmonised among Member States;
3. the **operational objectives** to address them:
 - (iv) to enhance loss absorption, permanence and flexibility of payments of going-concern capital instruments;
 - (v) to enhance loss absorption of regulatory capital by appropriate application of regulatory adjustments from the relevant layers of capital;
 - (vi) to develop a harmonised set of provisions in the area of definition of capital;

The present RTS are to fulfil the above objectives, by modifying eligibility criteria and making the necessary regulatory adjustments as adopted by the Basel Committee while allowing for adjustments that are necessary to take due account of specific EU issues⁶.

Issues addressed by the RTS and objectives

The proposed draft RTS provide technical supplements to the provisions of the CRR so as to contribute to fulfilling the objectives described above.

⁵See the impact assessment accompanying the CRR:

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

⁶ See policy option 3.5 in the ‘Eligibility of capital instruments and application of regulatory adjustments’ section of the Commission impact assessment accompanying the CRR.

The draft RTS specify the rules and conditions required to ensure a harmonised application of the different CRR provisions by addressing problem drivers (i) to (iii) and operational objectives (iv) to (vi) on the following topics:

- (a) deductions of direct, indirect and synthetic holdings from regulatory own funds;
 - a. broad market indices to be used for determining distributions on AT1 and T2 own funds instruments;
- (b) treatment of minority interests included in consolidated CET1 capital.

The provisions regarding indirect and synthetic holdings in other financial sector entities address the problem of inadequate loss absorption capacity of own funds, as well as the inadequate application of regulatory adjustments (deductions from capital). The draft RTS focus on the procedures needed to compute the exposure resulting from indirect holdings of own funds instruments. The operational objective of the RTS is to ensure that the proposed methods for computing indirect participations are sufficiently clear, while guaranteeing that these methods accommodate the different structures of indirect participation of credit institutions in other financial sector entities.

The draft RTS have taken proportionality into account in the implementation of the look-through approach and the structured approach by suggesting a materiality threshold. This threshold provides relief to positions that are small both relative to the institutions' CET1 and in absolute terms. The absolute limit of EUR 10million will be binding for institutions with a CET1 above EUR 4billion. For smaller institutions, the 0.25% CET1 limit will be binding.

The provisions on the use of market indices for indexing distributions on AT1 and T2 own funds instruments constitute one way of addressing the problem of inadequate features of loss absorption, permanence and flexibility of payments of own funds resources (see in previous section, problem driver (i); and associated operational objective (iv)). Whenever an institution issues AT1 or T2 instruments that pay investors interest rate linked/indexed to a market index type, i.e. an 'average price' of interbank lending/borrowing, there is a possibility that upon a worsening in the credit standing, and/or financial condition, the issuer will pay higher interest rates on AT1 or T2 instruments. This is likely to occur when the market index is highly correlated with the performance of the issuing institution, amid the issuing institution being a heavy component in the calculation of the index.

4. Any such credit-sensitive feature of interest/dividend payments is deemed to undermine the loss absorbency capacity of institutions' own funds, by requiring them to distribute larger amounts of resources during times of financial stress when, due to a own credit risk worsening, they should instead be retaining more capital resources.
5. The draft RTS provide the necessary set of conditions to define a 'broad market index', i.e. a market index that can be used as a base for determining the distribution of AT1 and T2 instruments. The objective of the draft RTS here is to strike the right balance between the need to ensure independence in the processes governing the index creation and low levels of correlation of the index with individual participants to the creation of the index, on the one hand, and the need to guarantee institutions operating in both local and cross-border

markets the access to available indices for referencing the remuneration of own funds instruments on the other.

The provisions on the topic of minority interests address the problem of inadequate loss absorption capacity and permanence of own funds resources. The recent financial turmoil, in this respect, showed that own funds resources owned by minority parties within subsidiaries can prove to be less loss-absorbing for the group to than for the subsidiary itself. The draft RTS define how to calculate the 'eligible minority interest', i.e. the minority interest of own fund resources that can be included in the own fund resources of the consolidating entity.

4.1.3 Approaches considered and expected impact of the proposals

Indirect and synthetic holdings

As a result of the provisions on the deduction of indirect and synthetic holdings of own funds instruments of other financial sector entities, and depending on the current levels of conservatism in the treatment of such deductions in the different EU jurisdictions, institutions domiciled in some jurisdictions are likely to face tighter capital requirements. **The aggregate outcome on capital requirements cannot be inferred given the lack of sufficiently detailed data on the current regulatory treatment of deductions for indirect and synthetic holdings in other financial sector entities.**

The draft RTS propose a method for the calculation of indirect holdings, applicable to all sorts of structures of indirect participation.

The aim of the alternative proposal of full deduction of the participation in the intermediate entity is twofold:

- (a) to incentivise institutions to carry out a look-through approach in all those cases where the institution expects the deductions resulting from such approach to be less conservative, and hence less material, than the deduction implied by the alternative approach;
- (b) to provide institutions with a proportionate alternative to the look-through approach in those cases where the look-through approach is deemed overly burdensome and hence not justified by the prudential outcome resulting from the look-through deductions.

Broad market indices

Data is not available on the characteristics of all market indices currently used for benchmarking the remuneration of AT1 and T2 instruments in EU jurisdictions and in local markets within the jurisdictions. Therefore no assessment can be done on the number and location of the institutions

that are going to have to change market indices used for the purposes of benchmarking remuneration to comply with the proposed criteria defining ‘broad market indices’.

The following subsections illustrate advantages and disadvantages of the approaches considered and adopted in the drafting of the provision dealing with market indices.

General approach

In drafting the provisions on broad market indices, two approaches were considered:

Approach 1: An ‘exclusive list’ approach where the draft RTS enumerate the interbank lending indices that shall be considered ‘broad market indices’.

Approach 2: A principles-based approach where the draft RTS describe the features that broad market indices shall present, both in terms of use of the index in the markets and limits of correlation in the construction of the index.

Approach (1) is not proposed in the draft RTS for interbank interest rates indices. Although an exhaustive list of indices would provide legal clarity and increased harmonisation, it would be a non-flexible regulatory reference that may exclude eligible items, i.e. either existing indices or indices to be introduced in the future.

Approach (2), based on principles, is considered to strike the right balance between the need to guarantee independence and granularity of the indices on the one hand, and the flexibility needed on markets where indices have to be identified for use as ‘broad market indices’.

Regarding equity indices, to have maximum consistency with the CRR, the RTS refer to the relevant provisions in the CRR itself. Those provisions refer to lists of stock indices.

Minority interests

The treatment of minority interests, for the purposes of consolidating own fund of a subsidiary to the own fund of the related group, differs across jurisdictions in the EU. For those jurisdictions where minority interests can currently fully contribute to the capital requirements of the consolidating group, it is expected that the proposed deductions of minority interests will result in consolidating groups facing tighter capital requirements, i.e. less eligible capital, in relation to the current framework. Due to the lack of relevant data, the fall in available eligible capital was assessed on the basis of the expert opinion of national supervisors.

4.2 Views of the Banking Stakeholder Group (BSG)

The main comments from the BSG were as follows: [*please note: article references are to the numbers of the articles as in the Consultation Paper (CP)*]

- The BSG is glad that the EBA intends to clarify how to identify and calculate the deductions for the indirect and synthetic holdings in financial institutions.
- The new draft RTS seem to go further than provided for by the EBA mandate in the CRR. The draft RTS do not take account of the operational burden in identifying indirect and synthetic holdings.
- As regards synthetic holdings in the form of options, the BSG is concerned that these draft RTS stipulate that the exposure shall be the notional amount of the relevant instruments instead of the delta value.
- The use of the look-through approach (LTA) as a default solution is burdensome and costly. As an alternative, the draft RTS allow use of the structure-based approach to estimate the value of the indirect holdings. This approach requires taking separate account of the amount that the intermediate entities hold in own CET1 instruments and the amount that the intermediate entities hold in the CET1 instruments of other financial sector entities on an aggregate basis. Such information is not readily available.
- It would be advisable to provide the following exemptions from the definition of indirect holdings in the RTS. Since paragraph 1 of Article 14(a) provides only non-exclusive examples, the BSG encourages the EBA to specify explicitly the exemptions to avoid any confusion or unintended consequences, especially in the following cases: entities already subject to the prudential supervision; controlled but non-consolidated companies for which the institution is already submitted to prudential requirements under the CRR; parent mixed activity holding company (MAHC) of the institution or the subsidiaries of the parent MAHC .
- Article 41 of the CRR states that assets in excess of liabilities in pension funds are to be deducted from CET1. Applying the look-through approach according to this draft RTS may therefore result in a partial double deduction for defined benefit pension funds.
- The draft RTS do not specify whether the proposed approach is applicable to trading book. For trading book positions, for which the holding period is supposed to be short, applying the LTA does not make sense. Moreover, the netting of short and long positions should be allowed.
- For entities which are not exempt, it would be highly advisable to provide materiality thresholds beyond which the LTA should be performed.
- The proposed assessment process for a bank holding more than 10% of CET1 instruments in paragraph 1 of Article 14(f)- introduces some changes to the level 1 text (Article 43(a) of the CRR) and is not consistent with paragraph 84 of the Basel III Accord.
- It is important that the regulatory technical standard rules reflect the ranking of creditors (senior debt exposure is only exposed to losses after equity/subordinated debt holders) and maximum loss potential when determining the methodology for determining indirect exposures to capital instruments of financial sector entities.
- It should be made clearer that minority interests from subsidiaries in third countries are indeed recognised.

4.3 Feedback on the public consultation and on the opinion of the BSG

The EBA publicly consulted on the draft proposal contained in this paper.

The consultation period lasted for eight weeks and ended on 18 July 2013. A total of 24 responses were received, of which 21 were published on the EBA website.

This paper presents a summary of the key points and other comments arising from the consultation, the analysis and discussion triggered by these comments and the actions taken to address them if deemed necessary.

In many cases, several industry bodies made similar comments or the same body repeated its comments in the response to different questions. In such cases, the comments and EBA analysis are included in the section of this paper where EBA considers them most appropriate.

Changes to the draft RTS were made as a result of the responses received during the public consultation.

Summary of key issues and the EBA's response

Indirect holdings:

1. Respondents suggested that including MAHC in the scope of the RTS would – because of the very broad definition of MAHC in CRR – have the unintended consequence of preventing institutions lending to certain corporates such as car manufacturers, because the senior funding would be construed as an indirect holdings in a banking subsidiary.

EBA response: EBA agrees to exclude MAHC from the list of intermediate entities for the purposes of indirect holdings and to clarify that the entities for which direct holdings of own funds instruments have to be deducted should not be considered as intermediate entities when these intermediate entities are also subject to similar deduction rules. Therefore, all financial sector entities such as mixed financial holding entities or insurance companies are excluded from the list of intermediate entities. As a safeguard, a new paragraph has been included to capture intermediate entities set up for the purpose of circumventing the deduction rules.

2. Respondents suggested that the look-through approach and the structured approach were too burdensome to be used in the case of immaterial indirect holdings.

EBA response: EBA agrees to introduce a materiality threshold for potential indirect exposures which are immaterial both relative to the CET1 of the institution and in absolute terms.

3. Respondents suggested that if an institution has no control or direct influence, by law or otherwise, over investments made in a defined pension fund, investment in that pension fund should not be considered as an indirect holding within the meaning of the CRR.

EBA response: EBA clarified that for defined pension funds meeting strict independence criteria, the rules regarding indirect holdings devised in the RTS shall only apply regarding holdings in own funds instruments issued by the sponsoring authority.

Synthetic holdings:

4. Regarding synthetic holdings, several respondents were concerned that deducting the notional of options was not adequate and that in most cases, the delta equivalent could be used instead.

EBA response: for the trading book, the delta equivalent of options can be used instead of the notional. The calculation of the delta equivalent shall be in line with the provisions for Market risk in the CRR. For the banking book, the treatment is to deduct the mark to market price of call options and the strike price of put options. For all others derivatives however, the reference to the notional has been kept.

Determination of significant investments:

5. Respondents argued that indirect and synthetic holdings should not be taken into account for the determination of significant investments under Article 43(a) of the CRR because these holdings will not grant ownership.

EBA response: for the purposes of Article 43(a), holdings that may give rise to direct or indirect ownership are included. Those positions are direct positions as well as indirect positions through entities over which the institution has control or significant influence as defined by the competent authority. The existence of large indirect or synthetic holdings may still be taken into account to determine the existence of a significant investment under Article 43(b) or 43(c) of the CRR.

Indices

6. Some respondents raised concerns that indices in smaller markets (like Denmark) could be excluded due to the relatively small number of contributors to that index. A number of contributors argued that indices should not be limited to those in relation to interest rates but should be expanded to stock indices, consumer price indices or commodities indices.

EBA response: an index is broad if it has six or more contributors, but that number may be reduced to four if those contributors are representative of the market. The use of equity indices is not prohibited. The use of inflation or commodities indices is outside the scope of the RTS as there is no correlation to the credit standing of the institution.

Minority interests

7. Several respondents wanted to ensure that minority interests from subsidiaries in third countries are recognised and argued that this should be included in the RTS, provided that they are subject to prudential regulation and supervision that results in a similar outcome to

that under the CRR. A few respondents also sought clarity for groups headed by a non-operating holding company and whether minority interests arising from a single top institution are fully eligible at the level of a parent holding company.

EBA response: there is a case for the inclusion of minority interests arising from intermediate holding companies in third countries but the level 1 text prohibits it. Similarly, the level 1 text prevents full eligibility of minority interest arising from banking subsidiaries at the level of a parent financial holding company, except in the case laid down in Article 84(5). The EBA believes that the non-operating holding company the question refers to is not covered by Article 84(5).

Summary of responses to the consultation and the EBA's analysis

| Comments | Summary of responses received | EBA analysis | Amendments to the proposals |
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| Responses to questions in EBA/CP/2013/17 | | | |
| <p>The answers to the consultation have been grouped in three blocks: deductions, indices and minority interests. Also, articles of the CRR are referenced as 'Article xx of the CRR' whereas articles referring to those of the draft RTS are mentioned only as 'Article xx'.</p> <p>For simplicity, some comments or answers to questions have been highlighted under the headers 'general comments' and 'other comments', especially when they respondents made similar comments when responding to different questions.</p> <p>Please also note that article references are to the numbers of the articles as in the CP. Those Articles in the CP may refer to Articles of the draft CRR (COM (2011) 452 final).</p> | | | |
| 1. Deductions (Article 14(a) to (i)) | | | |
| 1.1. General comments | | | |
| | Several respondents expressed a concern that the EBA had gone further in this draft RTS than the mandate in CRR allows for, since the mandate in CRR only refers to holdings, indirect holdings and synthetic holdings, whereas the draft RTS use the notion of 'capital instruments' which encompasses other categories of capital instruments. | The expression used in Article 14 of the CP is: 'indirect holdings of capital instruments pursuant to Article 33(1)(f), (h) and (i) of Regulation xx/XX/EU [CRR]'. The reference to the relevant article of CRR shows that the intended scope is in line with the mandate. | No change. |
| | Those respondents generally argue that the words 'but are not limited to' indicate a broadening of the definition of 'indirect holding' from what the co-legislators decided at level 1. | No broadening of the level 1 was intended. However, EBA agrees that those words can be deleted from Article 14(a)(1) of the CP. | Those words have been deleted from Article 14(a)(1). |

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| | <p>One respondent suggested replacing 'other than institutions' with 'other than financial sector entities'. The argument is that direct exposures to FSEs are already covered by 'synthetic holdings' as defined in the CRR. The broad definition of 'financial instrument' ensures that all exposure types are covered and that no circumvention of the related provisions is possible. This clarification would help to avoid confusion when distinguishing between indirect and synthetic holdings.</p> | <p>This wording has been changed, thereby further clarifying the scope of the definition of indirect entities.</p> <p>The EBA also notes that the definition of financial entities has been changed in the corrigendum to the CRR published on 30 November 2013. However the final RTS has to be drafted on the basis of the CRR existing prior to the corrigendum. Changes in this area in the post-corrigendum CRR will be monitored.</p> | <p>Wording changed.</p> |
| | <p>One respondent believed the EBA has potentially introduced new requirements through this RTS process. Issues of particular concern include multiple layers of intermediate holdings and look through, deduction for own capital instruments, deduction of large notional amounts in derivatives contracts with no correlation to risk, and potential defined benefit pension funds look through.</p> | <p>Disagreed. The EBA has worked consistently towards the completion of its mandate for these RTS. Nonetheless, amendments have been introduced on specific issues.</p> | <p>No specific amendments although various changes may alleviate concerns of this respondent.</p> |
| <p>Trading book</p> | <p>Several respondents were concerned that the proposed treatment would not be appropriate for the trading book and suggested different reasons for their concerns.</p> <p>Several respondents argued a symmetrical recognition of eligible short synthetic positions should apply (i.e. short call, long put options, short TRS or futures/forward contracts on a single name underlying) when calculating the net long position at underlying level in accordance with CRR. One respondent provided wording.</p> | <p>The treatment for the trading has been amended. In particular, the EBA noted the concerns of respondents regarding the deduction of the notional of options and agreed to permit the deduction of the delta equivalent amount instead.</p> <p>The EBA also noted remarks concerning the netting. However, the provisions regarding netting for the purposes of deductions from own funds are laid down in the level 1 text and cannot be changed in these RTS.</p> | <p>Treatment of options amended.</p> |

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| | <p>Two respondents suggested that further details are needed to be provided as to how exposure is to be measured when the bank may have long and short positions that, for example, could be offset.</p> <p>First, a net long exposure of a trading book to a fund or similar entity would be negligible if not null as any long position would be held to, or would hedge, a short position in the same underlying. If a look-through approach is to be used for trading book positions it should be only on the basis of the net long position. As a minimum, the netting of short and long positions should be allowed.</p> <p>In addition, the impact of not separating out the trading book net positions would run counter to the requirement to manage the trading book as noted in Article 103 of the CRR. In particular, Article 104(2)(c)(ii) of the CRR requires a bank to hedge all material risks. Risk management practices, including hedging of open positions on the trading book, also need to be taken into account. Such hedges may have differing maturity dates and meet the trading book rules but appear to create a long position for the purposes of Article 14. For trading book positions, the capital charges introduced under CRD III, for example the incremental risk charge (IRC), are already designed to capture loss from default in these instruments (as well as rating migration).</p> <p>The adoption of a full breakdown in trading book, particularly for any IITRAX positions, would be burdensome.</p> <p>Finally, it was suggested [EBF] that examples should be included in the annex.</p> | <p>It is not possible to include examples in the annex of a final RTS.</p> | |
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| | <p>One respondent also highlighted that market making to clients hedging market moves in the European financial credit indices referencing either senior or subordinated debt of 25 European financial names would be heavily penalised under the regulations by incurring a capital charge. They urged the EBA to give consideration to the treatment of these types of market making instruments.</p> <p>Another respondent suggested that Article 14(a) would have the effect of unnecessarily restricting market-making activity, potentially resulting in a significant reduction in market liquidity for financial institutions' equity.</p> | The EBA included a threshold which should take into account market making activities. | |
| | Several respondents were concerned about the notion of potential loss used in the draft CP. | The notion of potential loss refers to the loss that would be incurred by the institution referred to in Article 4 (114) of the CRR. | |
| | Other respondents suggested that further details should be provided on what 'the losses an institution would incur', 'not materially different' and 'supporting the investment risk' mean. | The EBA notes that the expressions 'the losses an institution would incur', 'not materially different' are part of the level 1 text (Article 4 (114) of the CRR). | |
| | One respondent added that from a practical standpoint, only holdings of capital instruments of an intermediate entity (i.e. direct holdings of common equity, preference shares (AT1) or subordinated debt instruments (T2) of the intermediate entities) will have features of loss absorbance and, therefore, will be exposed to the losses arising from the drop in the value of the capital instruments of other financial entities. | The level 1 text has been modified in the course of the negotiations to change the former wording of 'a direct holding of capital instruments' to 'any exposure' to align it with Basel and capture all forms of investments | |

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| | <p>One respondent added that it was important that Article 14 reflect the ranking of creditors (senior debt exposure is only exposed to losses after equity/subordinated debt holders) and maximum loss potential when determining the methodology for determining indirect exposures to capital instruments of financial sector entities.</p> | <p>The RTS provisions devise a deduction framework. It is impossible to say upfront which loss will be registered from a senior position so it is prudent to make an identical deduction for all types of exposures.</p> | |
| <p>Notion of potential loss</p> | <p>One respondent believed that this requirement for calculating the deduction amount conflicts with the Basel III definition of the amount to be deducted for synthetic (and indirect) holdings, which is the loss that the bank would suffer if the capital of the respective financial sector entity is written off. As a result they argued that the notional cannot be equated with the loss the bank would suffer in case of an insolvency of the respective financial sector entity and is therefore an unsuitable proxy for that loss.</p> <p>Also, the RTS discuss 'loss' in the context of the capital of the FSE being 'permanently written-off'. Whilst this makes sense in the equities markets, in the credit markets this implies default or restructure, either of which would constitute a credit event under ISDA.</p> | <p>The treatment of options in the trading and the banking book has been amended. The amended treatment should adequately reflect the potential loss.</p> <p>This is a level 1 issue. 'Permanently written off' is the notion used in Article 4(114) of the CRR.</p> | |
| <p>Look-through approach and structure-based approach</p> | <p>Several respondents were concerned that the look-through approach could only be used in very specific cases such as exchange traded funds. The look-through approach would be difficult to implement for all institutions regardless of size.</p> | <p>EBA agreed to introduce a threshold (see below).</p> | |

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| | <p>It is therefore important that the structure-based approach is a viable alternative. However, the structure-based approach requires information about the assets of the intermediate entity that may not exist if the look-through approach is not possible. For instance, it may not be possible to distinguish between investments in own shares from those in other financial sector entities.</p> <p>Thus, institutions will have to fully deduct exposures in the same way own shares are treated which would be punitive.</p> | | |
| 1.2. Responses to questions | | | |
| <p>Q01: Are the provisions of Article 14(a) sufficiently clear? Are there issues which need to be elaborated further?</p> | <p>A number of respondents agreed that the provisions in Article 14(a) were sufficiently clear and understandable within the regulatory technical standards.</p> <p>Other respondents however suggested that a number of clarifications were needed.</p> <p>Several respondents asked for clarification on the definition of intermediate entities used in the article. One of those respondents suggested clarifying the interplay between this definition and the CRR definition of financial institutions. Another respondent had concerns regarding the inclusion of funds within the definition of intermediate entities.</p> <p>Several respondents also looked for clarity on the definition of indirect holdings in the context of the RTS and in relation with the CRR text.</p> <p>Several respondents felt that the provisions were not clear regarding the definition of exposures and that it</p> | <p>The EBA believes that the clarification regarding the scope of the definition of intermediate entities tackles this comment.</p> <p>The changes made in the RTS will also clarify the notion of indirect holdings.</p> | |

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| | <p>needed further clarification to ensure consistent application.</p> <p>One respondent was concerned about the interplay of the proposal with the large exposures framework.</p> | | |
| Scope | <p>Most respondents to this question also looked for clarity about the scope of application of Article 14(a).</p> <p>In that respect the respondents generally asked for confirmation that the following entities were outside of the scope of Article 14(a):</p> <ul style="list-style-type: none"> - entities already subject to the prudential supervision under Article 49 of the CRR; - companies below the accounting consolidation thresholds and included in the scope of prudential consolidation; - The parent MAHC of the institution or the subsidiaries of the parent MAHC. <p>One respondent further specified by arguing that under Basel III, regulatory adjustments are limited to investments in the capital of 'banking, financial and insurance entities'. The CRR definition goes beyond this with the inclusion of 'Mixed Activity Holding Companies', 'Mixed Activity Insurance Holding Companies' and with a broad interpretation of 'Financial Institutions'. As a result, literal application of the CRR FSE definition covers corporate parents with operative business (for example, car manufacturers or energy companies), even when the financial activities within the group are insignificant, or corporate parents without any financial subsidiaries, simply due to the fact that a corporate has chosen to organise the group as a holding structure.</p> | <p>Partial agreement with the comments. While some particular suggestions have not been taken into account, the EBA agreed to clarify the scope of the definition of intermediate entities in the final draft RTS.</p> | |

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| | <p>One respondent suggested applying a materiality test to determine if an organisation is 'predominantly engaged' in financial services: to meet the definition financial services activities would make up e.g. 85% of an organisation's gross revenues or assets. Another possibility could be to apply a look-through approach to deduct only a part of the exposure to the organisation, representing the proportion that is engaged in financial activities.</p> <p>It is possible for a fund manager to fall within the scope of Article 4(8)(c), i.e. not be an institution within the meaning of Article 4(3). Therefore if the intention was to capture the situation where such a fund manager holds an investment in a financial sector entity on its own balance sheet, then Article 14(a)(1)(a) would not capture that situation.</p> | | |
| Significant investments /holdings | <p>Several respondents suggested that only direct holdings should be taken into account for the determination of significant investments under Article 40(a) CRR (<i>'the institution owns more than 10 % of the Common Equity Tier 1 instruments issued by that entity'</i>) because the gross long value of direct, indirect and synthetic positions do not convey any form of ownership or influence.</p> <p>One respondent thought that holdings in the trading book should also be excluded because these are not held in the medium or long term to extend or benefit the group's franchise.</p> | <p>Partial agreement. The way indirect and synthetic holdings should be taken into account for the determination of significant investments under Article 43(a) of the CRR has been clarified and is indeed based on the notion of ownership. However, there can be ownership in cases of indirect holdings.</p> <p>Synthetic holdings will not be taken into account under Article 43(a).</p> | |
| Level playing field | <p>One respondent stated that it was important that rules imposed in the EU are aligned with those on a global level. This is particularly important with regards to deductions from own funds.</p> | <p>While level playing considerations are important, the main goal of these RTS is to fulfil the mandate given in a prudent fashion.</p> | None. |

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| Securitisations | A number of respondents believed that securitisations should be deleted from paragraph 1 of Article 14(a) because the interplay with the securitisation rules would potentially result in double counting. | Disagreed. | None |
| Disclosure | <p>A number of respondents wished to have more clarity regarding the potential impact of the provisions regarding indirect and synthetic holdings laid down in technical standards on the disclosure of own funds published by the EBA.</p> <p>Those respondents suggested that the provisions on indirect holdings and synthetic holdings should be considered separately within disclosure.</p> | The EBA considers the disclosure template to be sufficiently granular as it is. | |
| Q02: Provisions included in paragraph 1 of the following Article 14(a) refer in particular to pension funds. These provisions have to be read in conjunction with the deductions referred to in Article 33(e) of the CRR. Would you see any cases where there might be an overlap between the two types of deductions? Please describe | <p>A large number of respondents referred to the potential for overlap between Article 33(e) of the draft CRR (Article 36(1)(e) final version) and the provisions of Article 14(a) referring to pension funds.</p> <p>The respondents generally argued that Article 36(1)(e) of the CRR already requires the firms to deduct the defined benefit pension fund asset recognised on their balance sheets. Further, the pension cost (used to finance the acquisition of all pension fund assets, including financial sector entities) will reduce CET1, as will the pension fund liability. As a result, the new requirement introduced in the draft RTS, to look through the defined benefit pension fund to capture the indirect holdings is a duplication.</p> <p>The requirement to look through to the assets of the pension fund managed by the firm ignores the diversification/offsetting effects of the other assets within the scheme.</p> | EBA agreed to clarify that for defined pension funds meeting strict independence criteria, the rules regarding indirect holdings devised in the RTS shall only apply regarding holdings in own funds instruments issued by the sponsoring authority. | |

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| precisely these situations and the nature of the problem. | | | |
| Pension funds are outside the scope of indirect holdings/ Pension funds are separate from the employer | <p>The view of a few respondents with respect to certain defined pension benefit funds, is that it needs to be clarified under Article 14(a)(1)(b) that if an institution has no control or direct influence, by law or otherwise, over investments made in a pension fund, investment in that pension fund should not be considered as an indirect holding within the meaning of the CRR.</p> <p>Two respondents suggested clarifying what would constitute 'a support to the investment risk' with regards to defined benefit pension funds. Any company having a defined benefit pension plan always supports that plan since pension obligations exists irrespective of there being a fund to assure those obligations or not. However, incurring a financial loss on an investment in a defined benefit pension fund doesn't necessarily mean that there is a need for financial support.</p> <p>One of the respondents wished to highlight that looking through to the pension fund for a bank's employees would seem to go against the spirit of legislation put in place to keep these funds separate from the control of the employer. Under IFRS the employer recognises the net surplus or deficit of the pension fund on its balance sheet but not individual assets or liabilities.</p> | EBA agreed to clarify that for defined pension funds meeting strict independence criteria, the rules regarding indirect holdings devised in the RTS shall only apply regarding holdings in own funds instruments issued by the sponsoring authority. | |
| Other | One respondent also requested clarity on how often pension fund assets are to be revalued. For example, under UK GAAP, the actuarial valuation of pension fund assets is required only once a year. | Rules regarding the revaluation of pension fund assets are not part of the EBA mandate under Article 36 of the CRR. | None |
| Q03: Please provide also some input on the potential impact? | Several respondents argued that if defined benefit funds are included in the scope of the RTS and notably due to the look-through approach, one unintended | EBA noted that the answers to this question could inform the policy choices on defined benefit funds without requiring changes of their own. | None |

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| <p>What would be the size of the deduction of defined benefit pension funds under the treatment proposed in the following article? Would the treatment cause a change in the investment policy of the pension fund with regard to such holdings, or have any other consequences for the operation of the defined benefit pension scheme?</p> | <p>consequence could be that sponsoring banks request changes in investment strategy to reduce their potential capital deductions from financial sector capital instruments. Such changes to investment strategy could introduce increases in risk in the pension schemes (through lower sector diversification) for current and future pensioners.</p> <p>One respondent wished to contribute the following:</p> <p>On a bank industry wide basis, approximately 15% of defined benefit pension scheme assets are comprised of holdings in the banking, finance and insurance sector, excluding MAHC. The reduction in demand for the affected instruments could have further consequences, as other investors may choose to avoid them too.</p> <p>The maximum investment mandate capacity approach is problematic for institutions providing financial services, such as inflation hedges, to pension schemes they do not sponsor, and could encourage such funds to use non-EU providers, or in the event of adverse pricing, to disinvest from financial sector capital instruments.</p> <p>One respondent added a number of issues:</p> <ul style="list-style-type: none"> - There may be an overlap between the Pillar 2 requirements in some jurisdictions and the proposed treatment. - Fund managers could reasonably be expected to reduce their allocation to financial institutions at times of market stress and exit fully before default. The suggested treatment would give no credit to the active manager role. - There should be an exemption for where financial institutions in pension schemes represent no more than say 15-20% of the scheme assets. <p>One respondent provided the following detail:</p> <ul style="list-style-type: none"> • They believe the impact is likely to be very high, | | |
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| | <p>the extent of which will depend on what is captured within the definition of 'exposure'.</p> <ul style="list-style-type: none"> • A great deal of bank legacy vehicles positions hold significant amounts of financial institution capital instrument which might not presently be on regulatory balance sheets; this would have the effect of adding to the holdings in the entity providing funding to those vehicles. • Although the EBA gives an alternative of deducting the entire exposure to the intermediary where full details of investment mandates or look through are opaque, this would not be applicable for own sponsored issues, and is of limited value. <p>Several of the respondents believed that the look-through approach would be expensive and burdensome to apply.</p> <p>One reason is that the trustees - that are entrusted with the management of those pension assets – act very independently. Reporting (e.g. for the purpose of annual reports) is often done by independent actuaries. Direct automatic linking of single transactions, which is required to look-through to single assets is practically (and legally) not possible.</p> <p>Two respondents noted that the structured-based approach is only applicable under the precondition that a look-through is too 'operationally burdensome'. The near final draft of RTS 2013-01 included thresholds depending on the CET1 of the institution that are practically impossible to meet given the very high volumes in pension assets. Those respondents would therefore welcome a more amplified applicability for the structured-based approach for pension funds. In addition, there should be a grandfathering rule, at least for positions from pension schemes which have been</p> | | |
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| | <p>build up before 1 January 2014. Thereby, a bank does not need to do full deductions but may risk weight these positions with 250%.</p> <p>One of the respondents highlighted the fact that according to Swedish Law there has to be a clear separation of control from the Institution and the defined benefit pension scheme, i.e. No company is allowed to have any influence whatsoever over a defined benefit pension scheme. However the proposed rules may still influence how credit institutions choose to secure their pension obligations and/or on how pension plans is drawn up in the future.</p> | | |
| <p>Q04: Do you agree with the examples of synthetic holdings provided in paragraph 2 of the following Article 14(a)? Should other examples be added to this list?</p> | <p>A number of respondents agreed that the examples of synthetic holdings were clear.</p> | | |
| <p>Q05: Are the provisions contained regarding synthetic holdings in paragraph 2 of the following Article 14(a) and in Article 14€ sufficiently clear? Do you agree that the amount to be</p> | <p>A number of respondents agreed that the provisions laid down in paragraph 2 regarding synthetic holdings are sufficiently clear</p> <p>One respondent felt that the provisions were not sufficiently clear in this regard.</p> <p>One respondent suggested the notional should be interpreted as the amount of instruments that the institution can receive (or the value corresponding to that amount).</p> <p>The majority of respondents to this particular question did not believe that the notional amount should generally</p> | | |

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| <p>deducted shall be the notional amount? Would you see any situations where another amount shall be used?</p> | <p>be used. Rather, respondents generally viewed the delta equivalent, which constitutes the effective equivalent position in the underlying security of the derivative instrument, as more appropriate.</p> <p>Two of these respondents suggested that in general, the relevant exposure value should be the one used for the capital calculation and reference should be made to the netting provisions. It would make sense to deduct the notional or nominal amount notably for total return swaps, guarantees or credit protection, and forward purchase agreements. However, notably for call options, the market value of the option should be used as the basis for the deduction.</p> <p>A number of respondents believed that the amount to be deducted should be linked to the amount representing the fair value of the instrument held via synthetic holding. There are different cases which would cause double-counting in different circumstances. The fair value reflects the current carrying amount of an instrument based on the applicable accounting standards.</p> | <p>The EBA agrees to use the delta equivalent amount for options in the trading book.</p> <p>The EBA agrees to use the market value of call options in the banking book.</p> | |
| <p>Maturity restriction</p> | <p>Several respondents believe that the issue of the 'maturity restriction' has not been appropriately addressed in the draft RTS and will lead to inappropriately large deductions. Only short positions which match the maturity of a long position or have a residual maturity of at least one year are eligible to determine net long positions. Though this requirement is incorporated into the level 1 text the industry has been in discussions with supervisors to explore mitigating approaches for implementing the requirements. They would welcome a dialogue with the EBA on these approaches to assess whether the EBA would be able to provide for a consistent approach under either an RTS, through the Q&A process, or through the issuance of guidelines.</p> | <p>The comments correctly state that the requirement is incorporated in the level 1 text. Therefore, it cannot be changed by these RTS.</p> | |

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| | <p>According to one respondent the wording of both Article 70(a) of the CRR and Article 14(h) of the CP ('contractual right to sell', 'obliged to purchase') is based on a Basel FAQ which specifically relates to the treatment of a physically settled forward sale. The CRR exemption from the maturity match requirement should be formulated in a way that applies the underlying rationale of the Basel FAQ to all types of short positions, including cash settled products that provide the same economic protection.</p> | | |
| <p>Q06: Are the provisions relating to the deduction of serial or parallel holdings through intermediate entities sufficiently clear? Do you see any unexpected consequences? Are there issues which need to be elaborated further?</p> | <p>A number of respondents agreed that the provisions relating to the deduction of serial or parallel holdings through intermediate entities are generally clear.</p> <p>One respondent did not believe that the approach was sufficiently clear.</p> <p>Several respondents considered that the RTS was not clear on tranching positions (i.e. how the transition through the debt waterfall would work in practice). Further guidance needs to be provided on who would bear the losses in which situations, and what principles firms need to apply in each circumstance.</p> <p>One of the respondents had the following points in relation to this area:</p> <ul style="list-style-type: none"> • The calculation for financing that includes tranches does not produce an appropriate outcome. • In their view the reason for this is the missing recognition of seniority for individual exposures. • This leads to a non-risk-adequate recognition in contrast to the application of the securitisation framework. | <p>T</p> <p>Disagreed. The EBA considers it important to keep an alignment between the own funds and the large exposures regime concerning tranching positions.</p> | |

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| <p>Q07: Are the provisions of Article 14(d) relating to a structure-based approach sufficiently clear? Are there issues which need to be elaborated further?</p> | <p>A number of respondents to this question agreed that the provisions of Article 14(d) relating to a structure-based approach are sufficiently clear.</p> <p>However, respondents noted that the structured-based approach is only applicable under the precondition that a look-through is too 'operationally burdensome'. The near final draft of RTS 2013-01 included thresholds depending on the CET1 of the institution that are practically impossible to meet given the partly very high volumes in pension assets. Respondents noted that the approach chosen could result in overly punitive deductions.</p> <p>One respondent suggested that:</p> <ul style="list-style-type: none"> • a full deduction approach seems unreasonable. • To make the calculation of indirect holdings referred to in Article 14(b) less burdensome from an operational point of view, exposures to intermediate entities that are <u>sufficiently granular</u>, should be risk weighted applying a 250% weighting instead of being deducted from their own funds. Granular exposures to intermediate entities should be defined as exposures where its largest underlying is below 5% of the total transaction (analogue to granularity threshold applied for large exposures requirements). • The requirements for classifying entities as 'significant' seem vague and partly inappropriate. <p>Pursuant to the CRR, a significant holding exists if</p> | <p>EBA agreed to introduce a materiality threshold for potential indirect exposures which are immaterial both relative to the CET1 of the institution and in absolute terms. Under the threshold, exposures will be considered non-significant investments.</p> <p>The threshold introduced by EBA partially takes into account the comment.</p> <p>The final draft RTS clarifies in which cases indirect and synthetic holdings are used for the determination of</p> | |
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| | (Article 43) 'the institution <i>owns</i> more than 10% of the Common Equity Tier 1 instruments issued by that entity' which pleads for the focus on direct investments. This would also be more consistent in comparison to the other two cases mentioned in Article 43 CRR that focus on a close link and/or inclusion in the same group (accounting consolidation). The concept of the CRR is obviously rather focused on a corporate law and capital-orientated relationship, that is on investments calculated on a direct and gross basis. The respondent believed a definition to be more adequate that only refers to positions that lead to such a relationship. A different concept would also lead to a virtually insolvable operational and calculation problem. | significant holdings under Article 43(a) of the CRR. | |
| 2. Indices (Article 24(b)) | | | |
| 2.1. General comments on the articles | | | |
| | A number of respondents had a concern that indices in smaller markets (e.g. Denmark) could be excluded due to the relatively small number of contributors to that index. They argued that the number of contributors should not be the deciding factor on whether an index should be excluded. | The EBA agrees to keep the option to have less than six contributors (but at least four) if they are representative of the market. | |
| | A number of contributors argued that the indices should not be limited to those in relation to interest rates. The respondent believed that indices based on stock indices, CPI and commodities for example could also be used | CPI or commodities indices should not display any correlation with the credit standing of the institution and are therefore outside of the scope of the mandate. | |
| 2.2. Responses to questions | | | |

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| <p>Q08: Are the provisions of Article 24(b) sufficiently clear? Are there issues which need to be elaborated further?</p> | <p>The majority of respondents to this question agreed that the provisions of Article 24(b) were sufficiently clear [Danish Mortgage Banks Fed. With one of these respondents adding that, the current version is clear but that they anticipate amendments when the final rate & index setting process has been agreed.</p> <p>Two respondents argued that in addition to interbank lending rates, the reference to stock indices (such as DAX, FTSE 100, MSCI World, S&P Global 100), or other indices, such as consumer price indices (CPI) or commodity indices should be possible, or provided the further criteria prescribed in the RTS are met. Those references would usually not be correlated to the credit standing of one institution.</p> <p>When a rate of interest is based on an index, it is usually sourced from a public data provider (for example, Reuters); if such a public data provider fails to publish prices (realistically this would only be where there was a natural disaster or act of terror), fall-back provisions apply which are agreed among market participants and frequently reassessed in standards recommended by market organisations (such as ISDA). Article 24(b) should not prevent the application of such market standards.</p> <p>One respondent would favour a hybrid approach of both an 'agreed list' of interbank lending indices, to provide market certainty on indices that can be used for reference without further consideration of general principles, and the general principles that may be used in the event an issuer wishes to refer to an index not on the 'agreed list'. As a minimum, it would be expected that the large benchmark indices in the most liquid currencies would be on the 'agreed list'. This would be subject to review and change, from time to time, with the onus on an institution and its local regulator to</p> | <p>The EBA agrees to make clear that equity indices that are not correlated to the credit standing of the issuer can be used. The precise rules to be followed will be laid down in the RTS.</p> <p>The draft RTS do not prevent the use of fall back provisions to be used in case of a failure of the public data provider to publish prices. However, the market standard calculated under those fall back provisions should itself meet the criteria laid down in these RTS.</p> <p>While this particular suggestion was not taken into account, the EBA believes that sufficient flexibility and clarity has been introduced in the final version of the RTS.</p> | |
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| | demonstrate that correlation does not exist in a local market index which they wish to add to the 'agreed list'. | | |
| Q09: What in your view is the best means for ensuring that the benchmark rate is not materially affected by the credit standing of an individual participating institution? The criterion of minimum number of contributors or that of minimum representativeness of the market or both? | <p>Three respondents advised that a smaller number of contributors do not necessarily imply a high level of correlation between the credit standing of the individual contributors and the index as described in the general comments to this consultation.</p> <p>One respondent commented that the representativeness of the participating institutions appears to be more relevant than the sheer number of parties involved, and that the number of participants is of secondary importance.</p> <p>One respondent noted that both approaches have merits, the requirement that a benchmark rate is calculated from a minimum number of contributors will be easier to police and hence is a superior way to ensure that the benchmark rate is unaffected by the credit standing of the relevant institution. An enhancement to this process would be to ensure that extreme rates were excluded from the calculation of the reference rate but, for such a process to work, it would be necessary to have a greater number of contributors than under normal circumstances.</p> | The EBA agrees to keep the option to have less than six contributors (but at least four) if they are representative of the market. | |
| Q10: What would be the minimum number of contributors to ensure this absence of correlation? If a minimum representativeness of the market was chosen as an | <p>Some respondents noted that the provisions should take into account that countries using local market indices may have a low number of contributions in the panel. The suggestion of six different contributors might be too narrow for smaller countries. One of these respondents added that as a back-stop measure the proposed minimum number of contributors of four together with a minimum representativeness of 60% could be appropriate.</p> <p>One respondent was of the opinion that if the index automatically excludes extreme results (high and low),</p> | The EBA agrees to keep the option to have less than six contributors (but at least four) if they are representative of the market. | |

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| <p>alternative route, how to ensure and calculate this representativeness ? Would the percentage of 60% be sufficient?</p> | <p>then a seven-bank sample would ensure a five-bank average. If the automatic exclusion was not a feature of the index, then a larger sample size of, say, ten banks should reduce the effect of extreme results to a de-minimis level. The respondent added that indices can best be controlled by monitoring the number of active contributors and by dispersing their published rates. If the market is insufficiently deep to sustain above seven (or ten) contributors, then the combination of a lower contributor hurdle (say five) and a market volume threshold of 60%+ may achieve the same objective.</p> <p>One respondent stated that they did not support setting fixed minimum percentages. As markets can be very different, the required and realised representativeness should be assessed on a case-by-case basis.</p> | | |
| <p>3. Minority interests (Article 34(b))</p> | | | |
| <p>3.1. General comments on the articles</p> | | | |
| <p>Scope – third country holdings</p> | <p>Several respondents wanted to ensure that minority interests from subsidiaries in third countries are recognised under Article 34(b).</p> <p>Several respondents commented that third country holding companies should be confirmed as eligible.</p> <p>Two respondents added that third country holding companies should be included, provided they are subject to prudential regulation and supervision that results in a similar outcome to that under the CRR. Not recognising such entities within the scope would break the chain of consolidations, thus making MI [minority interests] from institutions below the holding company,</p> | <p>The mandate of the EBA regarding minority interests is limited by the level 1 text.</p> <p>Under Article 81, minority interests arising from institutions in third countries qualify for inclusion in consolidated CET1.</p> <p>The EBA has some sympathy for arguments suggesting that minority interests arising from third country holdings should qualify for inclusion in consolidated CET1 but reads Article 81 as preventing it. As this is a level 1 issue, it cannot be changed in the RTS.</p> | |

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| | that would otherwise qualify, ineligible. Structural reform measures, such as the Liikanen proposals in the EU and national measures such as Section 165 of Dodd Frank in the US, are likely to increase the incidence of holding companies within banking groups. | | |
| Groups headed by non-operating holding company | <p>According to two respondents] the treatment of groups headed by a non-operating holding company, with an institution as the immediate subsidiary, is also unclear. Article 84 CRR and following apply the calculation of MI to the 'institution'. Since the top institution will not be the subsidiary of an institution, Article 84 suggests that there should be no restriction on the MI of the main operating bank. Any other interpretation would favour one group structure over another. Further the introduction of structural reform measures, such as Liikanen, have the potential to increase the incidence of holding companies and need to be taken into account.</p> | <p>The EBA reads the level 1 text as preventing the full inclusion of minority interests in the consolidated CET1 calculated at the level of the non-operating entity in that situation. The minority interests would qualify subject to the restrictions laid down in Article 84.</p> <p>Only financial holding companies mentioned under Article 84(5) of the CRR may benefit from a waiver of the provisions of Article 84.</p> | |
| Calculation | <p>Two respondents confirmed that they would use the method as outlined in the example in the CP.</p> <p>One respondent believed that there was room for interpretation around the calculation. Their interpretation was that the capital requirements are to be calculated at the sub consolidated level using the rules applicable to the parent company doing the group consolidation – i.e., for a UK consolidation group, the CRR/CRD and any additional requirements, including Pillar 2, set by the PRA.</p> <p>One respondent stated that in case of a combination of subsidiary A (sub-consolidated) of B [that is a subsidiary of M] & A (solo consolidated) they would first apply solo consolidation and then sub-consolidation.</p> <p>One respondent felt that the suggested requirement to perform two calculations is burdensome. Irrespective of</p> | | |

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| | <p>the outcome of these calculations, a bank will only be allowed to report the lowest eligible minority interest. It does not seem logical to provide a choice of two calculations if the most conservative outcome is always to be used. From that perspective, the sub-consolidation should apply. In the case of a combination of subsidiary A (sub-consolidated) of B [that is a subsidiary of M] & A (solo consolidated) they would first apply solo consolidation and then sub-consolidation. The respondent felt that if there were to be two calculations, a bank should be allowed to choose one and deduct the amount that results from the chosen calculation.</p> <p>One respondent explained that this is how they would perform the calculation: It should be possible to take into account minority interests in intermediate holdings, which are neither directly nor indirectly subject to the CRR, at the level of the entity obliged to consolidate to the extent of Article 81(1) of the CRR, provided that that entity can dispose of the minority interests by way of contract or in reality.</p> | | |
| 3.2. Responses to questions | | | |
| Q11: How would you treat minority interests arising from an institution permitted, under Article 8 of the CRR, to incorporate a subsidiary in the calculation of its solo requirement (individual | Two respondents think that Articles 81 and 82(a)(ii) indicate that such entities are eligible. As a result of being part of the individual consolidation they will be subject to the requirements of the Regulation and should thus regarded as within scope. Furthermore, such entities will also be subject to the strict requirements of Article 9, which includes case by case assessment. | Disagreed. For the purposes of the calculation of minority interests, any waiver granted under Article 9 of the Regulation (EU) No 575/2013 shall be deemed not to have been granted. In particular, minority interests arising from SPVs included in a solo consolidation shall not be taken into account. | |

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| consolidation method)? | | | |
| <p>Q12: How would you treat minority interests arising from a subsidiary not subject to supervision on a sub-consolidated basis although it is the parent undertaking of other institutions? If the subsidiary would be allowed to undertake the calculation referred to in Article 79(1) on the basis of its sub-consolidated situation, some conditions would have to apply in order to secure this calculation in the absence of supervision on a sub-consolidated basis. What would you propose as conditions?</p> | <p>Several respondents suggested the minority interest arising from a subsidiary not subject to supervision on a sub-consolidated basis but which are the parent undertaking of another institution should be eligible. They provided the following arguments;</p> <p>Sub-consolidations are not necessarily required for every possible consolidation point within a banking group's structure. Notably, consolidation is only required at the highest level of a group within one jurisdiction. Provided that consolidation is prepared at the highest level within a jurisdiction (or at the level of the regulated parent entity immediately above) and the scope of consolidation covers all the entities that would be required in any sub-consolidation, the requirement for sub-consolidation should be deemed to have been met.</p> <p>The group requirement should be used here. Under the formula set out in the Annex 1, page 28 of the draft RTS, if an unregulated entity was included, the output would always be 20% of 0 which is counter-intuitive. Therefore, the formula should not apply in this case. Alternatively, a hypothetical consolidation could be used. The situation may also arise in third countries, where consolidated supervision is undertaken locally, but returns are not submitted on the sub-group to the consolidating supervisor. In that case, there should be equivalence determinations, and supervisory co-operation agreements should address any additional information requirements. In addition, the subsidiary may be subject to requirements that result in 'de facto' minimum capital requirements equivalent to those resulting from the sub-consolidation (Article 81(a)(ii)). This is the case where the subsidiary is not subject to</p> | <p>Level 1 issues for third country holding companies as well as for top holding with only one institution directly underneath (see above).</p> | |

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| | <p>minimum requirements but is required by law to be funded through common equity with no option of leveraging through external funding or from other companies of the same group, and whose only activity is to hold the stakes in the subsidiaries (no other intra-group transactions are allowed).</p> <p>One respondent emphasised that Article 84 should be interpreted as recognising local prudential requirements if these are higher than the requirements at consolidated level. Article 84 should be read as meaning that the only difference in the calculation between (i) and (ii) is the elimination of intra-group positions but the minimum ratio to apply should be the higher between the consolidated and the local.</p> <p>One of the respondents suggested creating a materiality threshold for the situation where minority interests arise from a regulated subsidiary, which is itself a parent of other financial entities but where the minority interests arise exclusively from the parent subsidiary. In the situation where its subsidiaries are considered immaterial and, in the absence of supervision on a sub-consolidated basis, the relevant position for calculation of the eligible minority interests could be derived from its solo capital resources and requirements.</p> <p>One respondent proposed the following conditions to take account of the minority interests arising at the level of a non-regulated intermediary subsidiary. Non-regulated subsidiaries shall not exceed x% of total assets on a sub-consolidated basis, and the principal activity of the intermediary subsidiary is to holding share capital of the sub-consolidated group.</p> | | |
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