Committee of European Banking Supervisors

CEBS

23 June 2006

First part of CEBS technical advice to the European Commission on own funds

Survey of the implementation of the current rules on own funds across Member States

Background

1. At its 24 November 2004 meeting, the European Banking Committee decided to undertake a review of the definition of own funds which would form the basis of the EU's future thinking on own funds. This follows the announcement of the Basel Committee's intention to start a review of the definition of capital. The European Commission ('the Commission') established an Own Funds Working Group composed of representatives of the Ministries of Finance and chaired by the Commission.

2. On 20 June 2005, the Commission asked CEBS to inform its work by providing technical advice through:

    a. a survey of the implementation of the current rules on own funds across Member States;

    b. an analysis of the capital instruments recently created by the industry;

    c. the development of guiding principles behind own funds; and

    d. a quantitative analysis of the types of capital held by credit institutions within the member states

3. CEBS was invited to provide the surveys referred to in points (a) and (b) above by August 2006, while the timescale for the two remaining pieces will be specified in due course. The call for advice is posted on the CEBS website in http://www.c-ebs.org/Advice/OF_mandate.pdf .

4. As required by point (a), CEBS report provides a review of the implementation of the current rules on own funds across member states and gives a snapshot of the supervisory practices in place.

5. Where relevant, the report also provides insights into the proposed manner of implementation of the few new provisions contained in the Capital Requirements Directive (CRD) which recasts Directives 2000/12/EC and

93/6/EEC related to own funds and serves to point out where there are commonalities and differences between rules.

Methodology

6. CEBS launched a detailed questionnaire to its members in order to obtain an up to date description of the current regimes for own funds in the EU. The answers have also been used to investigate further the current regulatory treatment of innovative capital instruments. The questionnaire is accessible by clicking on www.c-ebs.org.

7. This survey is based on the responses provided by all member states and one EEA member (Norway) to this questionnaire. For ease of comparison, information has been compiled and summarised in various tables in Annexes 3 to 10.

8. In the case of the new provisions which have been introduced when recasting the two Directives 2000/12/EC and 93/6/EEC, member states have indicated their intentions about implementation. These indications should be considered to be provisional and not necessarily final decisions.

9. The report has been produced from the perspective of supervision on a consolidated basis but highlights the impact on the list of eligible items which is related to supervision on a solo basis.

10. The report employs the terminology used by the CRD (i.e. original, additional, ancillary own funds), while keeping in mind that market participants usually refer to 'tiers' of regulatory own funds. Using the 'tier' terminology could have been misleading as there are technical differences between the items listed as regulatory own funds by the CRD and the calculation of regulatory own funds based on the Basel Capital Accord. Annex 1 below provides a corresponding table between the two terminologies.

11. For the sake of consistency, the report uses the terminology adopted for the BAC-GTIAD Survey[1] carried out in 2001 which CEBS was invited to update. Therefore, although the CRD does not sub-divide original and additional own funds into sub-categories, this report replicates the distinction adopted by the BAC-GTIAD Survey of 'core' and 'supplementary' own funds within each of the two layers of original and additional own funds. Annex 2 below provides the Denominations of own funds proposed by the BAC-GTIAD survey.

12. Capital-raising instruments have recently been used by institutions to raise funds in a cost-efficient and less dilutive way and have been designed to be included in eligible regulatory original own funds. Various terms are used to refer to these instruments. The industry and international rating agencies commonly refer to 'hybrids', as they combine to some extent the features of both debt and equity. Preferred shares are often but not always included in

---

[1] Revision of the EU legislation on the Own Funds of Credit Institutions and its Implementation in the Member States, February 2001, Interim Report by the Own Funds Directive Working Group, MARKT/1005/01-EN.

this definition by virtue of their similarities with other preferred securities. The term 'innovative' is also used, by reference to the wording of the Basel press release of 27 October 1998. However, 'innovative' may be restricted to a specific part of hybrid instruments, those eligible for original own funds and including an incentive to redeem, e.g. step-up. By contrast, 'non innovative' means that the instrument does not bear any incentive to redeem.

13. In order to avoid confusion between these various definitions, the report refers to 'hybrids' as a generic term which includes preferred securities, preferred shares, which some member states include as core original own funds, and any other form of capital eligible as supplementary original own funds. The term 'innovative' or 'hybrid with an incentive to redeem' refers to hybrids that contain specific feature creating an incentive to redeem such as step up.

14. With regard to the accounting treatment, the report highlights the modification to the composition of eligible items the International Financial Reporting Standards IAS/IFRS introduces and refers to the more detailed work already undertaken by CEBS on IAS/IFRS and prudential filters[2].

15. Within the framework of the Joint Protocol between CESR, CEBS and CEIOPS and the 3L3 Work Programme for 2006, CEBS and CEIOPS' expert groups have informed each other about their respective work.

16. Informal dialogue with experts designated by the CEBS Consultative Panel and banking associations was organised to get their initial views on the main findings of this survey.

Executive summary

17. The ultimate objective of the own funds of an institution is to absorb losses which are not covered by a sufficient volume of profits, thus ensuring the continuity of the institution and the protection of depositors. On an on-going basis, and along with debt, they also fund the assets of the institution and serve as an important yardstick for the competent authorities and the market to assess the financial and prudential soundness of institutions.

18. In Europe, regulatory own funds are composed of two main layers[3]: original own funds which are of the highest quality and permanence, and additional own funds, which have lower quality and are less permanent. To cover market risks, institutions can also use ancillary own funds. The EU legislation (the Capital Requirements Directive – 'CRD') has established the list of items (Article 61) each of these regulatory layers can be composed of in Europe. The survey details those items considered to be eligible in each member state.

---

[2] http://www.c-ebs.org/prudential_filters.htm ; http://www.c-ebs.org/press/14022006.pdf

[3] Subject to technical differences, these layers correspond to the commonly-used terminology of Tier 1 and Tier 2. Capital instruments used to cover market risks (Ancillary own funds) are commonly referred to as Tier 3. See Annex 1 below

19. Although the items listed by the CRD may be differently defined in member states, mainly because of the diversity of company and accounting laws, there is a set of fundamental criteria that regulatory own funds are assessed against, and this is commonly applied across Europe.

20. To be eligible for regulatory own funds, capital instruments should meet three criteria (i) permanence, (ii) loss absorption, and (iii) flexibility in the amount and timing of distributions/payments. The extent to which these criteria are fulfilled determines both the classification of capital instruments into the different layers of regulatory own funds and any limitations on their use.

21. Two main events have recently raised issues with regard to regulatory own funds:

- As the investor base develops, hybrid instruments have been created by institutions with the aim of generating the highest quality of regulatory own funds in a cost-efficient way. The EU legislation, however, does not yet reflect these market developments. Therefore it is on the basis of the work carried out by the Basel Committee at G-10 level that European supervisors have further elaborated the set of conditions mentioned above that capital instruments should meet in order to be considered as eligible for regulatory own funds. Moreover, European supervisors have set limits on the extent to which these instruments can be included in original own funds.

- The introduction of IAS/IFRS has also raised concerns about the impact of volatility in institutions' financial statements and, more particularly, in regulatory own funds, which might not reflect the economic substance of institutions' financial positions. This could in turn jeopardise the set of fundamental criteria that regulatory own funds have to fulfil.

22. In general, CEBS found that member states share a lot of commonalities with regard to the core objectives of own funds. Variations in national rules arise either from the flexibility granted by the CRD, or as a result of local market specificities, differences in national tax and company laws or in prudential approaches.

23. CEBS notes that working in parallel with the Basel Committee is crucial to ensure consistency and level playing field at international level.

24. More specifically, the main findings of the survey are :

25. In all member states, capital and reserves form core original own funds which are available to an institution for unrestricted and immediate use to cover risks or losses. Original own funds possess the highest capacity to absorb losses and there are no limits on their use for regulatory capital purposes.

26. The introduction of IAS/IFRS and the application of CEBS prudential filters have introduced or will introduce necessary adjustments to regulatory own funds, i.e. impacting core original as well as core additional own funds.

27. Following the Basel press release of 1998[4], some member states have included new capital instruments (commonly designated as 'hybrids' as they mix features of debt and equity) into original own funds on the grounds that they have similar characteristics although they do not have the same strength as the core original own funds.

28. These hybrid instruments are designed to fit into specific domestic legal and fiscal regimes. The new category of original own funds therefore encompasses a wide range of instruments with very different features.

29. As the CRD has not been updated to specify a common treatment of these hybrid instruments, and in order to ensure a level playing field among institutions while ensuring that the quality of original own funds is maintained, supervisors have tried to apply consistently a set of three main criteria: permanence, loss absorption and flexibility of payments. However, divergences, especially with regard to the extent that these instruments are included in original own funds, remain.

30. When members recognise hybrid instruments as eligible, two different situations exist:

    - the majority of members apply a 15% limit to hybrids with incentives to redeem, consistent with the 1998 Basel Press release

    - differences are wider with regard to the limit on the total of hybrid instruments (taking into account also hybrids with incentives to redeem), which can reach 50%.

31. With the second layer of own funds, namely additional own funds, the conditions of eligibility laid down in the CRD have in general been consistently implemented by member states.

32. With regard to core additional own funds, the majority of member states only accept as eligible undated instruments; however a few have recognised dated instruments or have set a very low minimum maturity period before the first call can be made.

33. A majority of member states require institutions to obtain prior supervisory approval before considering securities of indeterminate duration to be eligible as core additional own funds.

34. Safeguards have been put in place to ensure that capital instruments qualifying to core additional own funds are permanent. For instance, prior approval by the supervisory authority before a call can be exercised is a common practice.

35. Member states are also cautious that too high a level of step up may lead the issuer to redeem the instruments in circumstances which could jeopardize its financial soundness. Some member states have formally set levels that cannot

[4] Please click www.bis.org/press/p981027.htm

be exceeded, others have informal levels. In both cases, the range is from 50 bp to 150 bp.

36. With regard to supplementary additional own funds, the main differences among member states relate to the amortisation of subordinated loans during the last five years before their repayment date.

37. Regarding the deductions of participations in insurance companies, no uniform methodology seems to be applied by the member states. This issue which is particularly difficult to address from a technical angle will be further developed, along with the possible reflections and analysis about the consequences of the implementation of the Financial Conglomerates Directive on the sectoral measurement of the own funds.

38. With regard to ancillary own funds, most member states have, formally and explicitly, made use of the option to allow an alternative determination of own funds specifically to meet capital requirements in respect of institutions´ market risks. Most of those member states that have not formally and explicitly implemented this possibility, allow the inclusion of specific items, mainly short-term subordinated loan capital to meet these particular capital requirements.

39. The main requirements on instruments used to cover market risks (i.e. short-term subordinated loan capital) are generally implemented consistently by member states, following the CRD requirements in this area. More divergent approaches exist on the extent to which these instruments can be included.

INTRODUCTION 9

CHAPTER 1: ORIGINAL OWN FUNDS 10

SECTION 1.1. CORE ORIGINAL OWN FUNDS ARE THE STRONGEST ELEMENTS OF REGULATORY OWN FUNDS 10
1. Capital 11
a. Capital has been defined by the Directives regardless of its actual designation under the various legal structures institutions can adopt within the EU 11
b. The same characteristics of capital are commonly used across Europe 13
c. In half of the member states, capital reduction is subject to prior supervisory approval 14
2. Reserves 14
a. Reserves, as defined in the Directives, are generally treated quite similarly across member states, differences in the types and denominations of legal and statutory reserves arising as the result of different national company laws 14
b. Regardless of their legal and accounting definitions, reserves are included in core original own funds because of their ability to absorb losses and their permanence. 15
3. Funds for general banking risks 17
a. Not all member states have exercised the option to include funds for general banking risks in original own funds 17
b. The introduction of IAS/IFRS has led to the transfer of funds for general banking risks to the category of reserves. 18
4. Adjustments due to the revaluation effects introduced by the application of IAS/IFRS 18
5. The calculation of core original own funds 20
a. There is a high degree of commonality on the way the deductions set out in the CRD are to be made 21
b. Several member states deduct other items in addition to those listed in the CRD 21
6. The calculation of core original own funds on a consolidated basis 22
a. The elements of consolidated reserves listed by the CRD are taken into account differently 22
b. The calculation of own funds on a consolidated basis has been impacted by the introduction of IAS/IFRS 23
SECTION 1.2. SUPPLEMENTARY ORIGINAL OWN FUNDS 24
1. Supplementary original own funds encompass a wide range of instruments 25
2. National competent authorities assess supplementary original own funds against three key eligibility criteria 27
a. The vast majority of hybrids included in original own funds are structured to be permanent 27
b. Loss absorption both on a going concern basis and in liquidation is so essential that capital hybrids which do not fulfil this criterion do not qualify as original own funds in any country 28
c. Institutions must have full flexibility of on-going payments 30
3. Differences between a core additional own funds instrument and a supplementary original own funds instrument 31
4. Supervisors have included hybrids in original own funds subject to different limits 32

CHAPTER 2: ADDITIONAL OWN FUNDS 34

SECTION 2.1. CORE ADDITIONAL OWN FUNDS 35
1. Revaluation reserves referred to in Article 57(d) 35
2. Positive fair value revaluation reserves for institutions applying IAS/IFRS rules 35
3. The value adjustments referred to in Article 57(e) 37
4. Other items referred to in Article 63(1) and in new Article 63(3) 38
5. Securities of indeterminate duration, undated cumulative preferential shares and other instruments that fulfil a set of five conditions may be included in regulatory additional own funds in accordance with Article 63(2) 39

a. Safeguards have been put in place to verify that the requirement that these instruments may not be repaid on the bearer's initiative or without prior agreement of the supervisory authority, is fulfilled 40
b. In all member states, the debt agreement must provide that the credit institution has the option of deferring the payment of interest on the debt 42
c. All Member States require that the lender's claim on the institution is subordinated to all non subordinated creditors 42
d. The documents governing the issue of the securities must provide for debt and unpaid interest to be such as to absorb losses, whilst leaving the credit institution in a position to continue trading 42
6. The part of hybrid instruments recognised as supplementary original own funds which exceeds the limits imposed by supervisors is taken into account in core additional own funds 43
SECTION 2.2. SUPPLEMENTARY ADDITIONAL OWN FUNDS 43
1. Fixed-term cumulative preferential shares and subordinated loan capital as referred to in Article 57(h) are subject to five conditions of eligibility 44
a. Although all member states apply an amortising plan to subordinated loans during the last five years before the repayment date, the manner of application (e.g. the amortization rate and the time of amortization) differs. 45
b. Additional criteria may be considered by supervisors.................................. 46
2. A very limited number of member states allow inclusion of the commitments of the members of institutions set up as credit cooperatives, referred to in Article 57(g) 46
SECTION 2.3. ADDITIONAL OWN FUNDS CANNOT EXCEED ORIGINAL OWN FUNDS AND SUPPLEMENTARY ADDITIONAL OWN FUNDS CANNOT EXCEED 50% OF ORIGINAL OWN FUNDS 47

CHAPTER 3: THE CALCULATION OF TOTAL OWN FUNDS 48

SECTION 3.1. THE CRD REQUIRES A SET OF ITEMS TO BE DEDUCTED HALF FROM ORIGINAL OWN FUNDS AND HALF FROM ADDITIONAL OWN FUNDS 48
1. The approach to deduction of the holdings listed in Article 57 (l) to (n), (q) and (r) is generally similar across Europe 49
2. Member states have implemented or intend to implement Articles 57(o) and (p) in rather different ways 50
3. The calculation of regulatory own funds for the purpose of Large exposures and qualifying holdings outside the financial sector 51
4. Member states have indicated their intended choices of implementation of the new national discretions laid down in Articles 58, 59 and 60 of the CRD 51
SECTION 3.2. SOME MEMBER STATES HAVE INDICATED THAT THEY DEDUCT FROM REGULATORY OWN FUNDS ITEMS THAT ARE NOT LISTED IN THE CRD 52

CHAPTER 4: ANCILLARY OWN FUNDS 53

SECTION 4.1. ANCILLARY OWN FUNDS SHARE THE SAME KEY COMMON BASIC FEATURES 53
SECTION 4.2. ANCILLARY OWN FUNDS ARE MAINLY COMPOSED OF NET TRADING BOOK PROFITS AND SUBORDINATED LOAN CAPITAL, FROM WHICH ILLIQUID ASSETS ARE DEDUCTED 54
1. Net trading book profits 54
2. Subordinated loan capital 54
a. Subordinated loan capital shall meet five criteria to be eligible as ancillary own funds 54
b. Subordinated loan capital is subject to limits 56
3. Illiquid assets 57
4. Implementation of Article 16 with regard to Investment Firms 57
5. Implementation of Article 17 - capital requirements for settlement risk as regards 'free deliveries' 58
6. Other provisions relating to the trading book – standards for less liquid items 58

CONCLUSION 58

ANNEXES 59

Introduction

1. The current own funds regimes are based on the provisions of Directive 2000/12/EC and Directive 93/6/EEC, which have been recast into a single Capital Requirements Directive (CRD). The CRD also reflects in EU legislation the revised framework for the International Convergence of Capital Measurement and Capital Standards ('Basel II') published by the Basel Committee on Banking Supervision ('the Basel Committee').

2. The definition of eligible capital set out by the CRD has its roots in the Basel Accord on 'International Convergence of capital measurement and capital standards' of July 1988. However, it does not take into account the Basel Committee's Press Release[5] on 27 October 1998 'Instruments eligible for inclusion in Tier 1 capital' ('the Basel press release'). The CRD however incorporates a few adjustments deemed necessary in the context of the implementation of the Basel II' in the EU.

3. The CRD sets out the general principles for the consideration of own funds, the maximum list of eligible items and amounts and the way they are split up into different categories and taken into account for regulatory capital purposes.

4. According to the nature of the items, the CRD[6] distinguishes two types of own funds, original own funds and additional own funds. The recast Directive 93/6/EEC introduces a category of own funds which has the sole purpose of meeting specific capital requirements, identified in this report as ancillary own funds.

5. The definitions of own funds set out by the CRD are applicable to both credit institutions and investment firms[7]. Where relevant, it has been indicated when the rules differ between credit institutions and investment firms.

---

[5] Please click www.bis.org/press/p981027.htm

[6] The CRD does not provide any explicit definition of its the layers of own funds. However, the expressions "original own funds" and "additional own funds" are mentioned in the recitals (26) and (27) of the recast Directive 2000/12/EC and Article 12 of the recast Directive 93/6/EEC.

[7] Article 12 and 13 of the recast Directive 93/6/EEC

CHAPTER 1: ORIGINAL OWN FUNDS

6. Original own funds are key elements of institutions' own funds: they are the basis on which both supervisors' assessment and markets' judgements of capital adequacy and financial soundness are made.

7. The CRD (Article 61, second paragraph) sets out the general principles that own funds must follow, i.e. such items shall be available to an institution for unrestricted and immediate use to cover risks or losses as soon as they occur. In that respect, original own funds have the highest capacity to absorb losses and there are no limits to their use for regulatory capital purposes. They must be (i) issued and fully paid-in, (ii) permanent, (iii) available to absorb losses on a going-concern basis and under stress, and (iv) provide the institution with full discretion as to the amount and timing of distributions.

8. The CRD states that three items shall compose original own funds: capital, reserves, and funds for general banking risks, from which own shares (at book value) held by the credit institution, intangible assets and material losses for the current financial year shall be deducted. However, as international markets for capital instruments developed, a variety of new capital instruments have been issued and considered to be eligible to be included in regulatory original own funds, on a case-by-case basis, provided that certain conditions relating to their ability to absorb losses, permanence and flexibility of payments are fulfilled.

9. To differentiate between capital, reserves, funds for general banking risks and these new instruments, the BAC-GTIAD Survey used 'core' original own funds to refer to items already listed in the CRD and 'supplementary' original own funds to refer to all the other instruments. This report has adopted the same terminology.

Section 1.1. Core original own funds are the strongest elements of regulatory own funds

10. Article 57 (a) to (c) of the recast Directive 2000/12/EC and Article 12 of the recast Directive 93/6/EEC for investment firms list the three items eligible for original own funds:

    (a) capital, plus share premium accounts but excluding cumulative preference shares,

    (b) reserves and profit and loss brought forward as a result of the application of the final profit or loss, and

    (c) funds for general banking risks.

11. Capital and reserves are key elements of core original own funds: they are common to all member states' banking systems, although taking different legal forms, and they are wholly visible in the published financial statements.

12. They must be fully paid-in, permanent and available to absorb losses on a going-concern basis and under stress conditions, i.e. the institutions have full discretion as to the amount and timing of their distributions, they are able to stop payments if the institution's solvency does not allow them and use the funds to absorb losses until the latter exceeds the funds.

13. There is no limit to the amount of core original own funds institutions can hold.

1. Capital

a. Capital has been defined by the Directives regardless of its actual designation under the various legal structures institutions can adopt within the EU

14. Article 57(a) states that Capital within the meaning of Article 22 of Directive 86/635/EEC, so far as it has been paid up, plus share premium account, but excluding cumulative preference shares, constitute original own funds.

15. Article 22 of Directive 86/635/EEC, Liabilities: Item 9 - Subscribed capital, states that subscribed capital shall comprise all amounts, regardless of their actual designations, which, in accordance with the legal structure of the institution concerned, are regarded under national law as equity capital subscribed by the shareholders or other proprietors.

Paid-up capital

16. All member states and Norway include provisions within the meaning of Article 22 of Directive 86/635/EEC. However, depending on the legal form the institution has adopted, paid-up capital may have different forms.

17. When registered as registered commercial companies, stock corporations or limited liability companies, paid-up capital takes the form of ordinary shares, which represent the legal and direct ownership of the institution (with voting rights) and preference shares to which generally no voting rights are attached.

18. Institutions may also take the form of Cooperative banks in a large number of member states[8]. Cooperative members' right of retirement coupled with the repayment of capital upon retirement are unfettered. Membership aims at mutual support among members on a reciprocal basis rather than investment.

19. Under IAS 32 cooperative shares may be classified as a liability. From a prudential perspective, most national supervisors reported that they follow or

[8] Austria, Belgium, Cyprus, Denmark, Finland, France, Italy, Germany, Greece, Hungary, Poland, Spain and the Netherlands

intend to follow the CEBS guidelines on prudential filters and continue to accept the capital of cooperative banks as capital within the meaning of Article 57(a), even if accounting rules would lead it to be classified as a liability.

20. Several member states[9] reported that they include the capital elements of savings banks, although these may not have voting rights related to them. In Germany, for example, savings banks are public corporations *sui generis*; only in some cases vested with endowment capital, which is neither issued nor with voting rights attached to it. The holders of the issued capital of savings banks in Norway (PCC Capital) on the other hand have influence (although not a decisive one) in the bank's highest body.

21. Three member states reported special rules for the recognition of capital of Mortgage Banks or Building Societies (Austria, United Kingdom and Ireland). Paid-up capital provided by partners under a partnership agreement is recognised in a few member states (France, Germany and United Kingdom).

22. Germany acknowledges permanent as well as dated[10] silent partnerships according to commercial law as part of paid-up capital, provided that they fulfil the principles mentioned in paragraph 7 above. In this connection it should be stressed that loss absorption takes place *pari passu* with shareholders/proprietors.

23. In Italy, within the capital of listed banks a special kind of shares denominated as "saving shares" ("azioni di risparmio") can be included up to a limit of 50% of total share capital. These shares are non-cumulative, permanent, have no voting rights and give full and unconditional loss absorption. The shareholders have special rights over the dividends of the bank if there are distributable profits.

24. During the 1991-1994 Scandinavian banking crisis some Scandinavian countries included temporary capital elements in their banking regulations. In the case of Sweden, those rules have already been abolished. Norway – theoretically - may still include guarantees furnished through statutory guarantee schemes on terms approved by Kredittilsynet. However, this provision has not been applied since 1994.

Share Premium

25. Although Article 57(a) includes share premium within the definition of capital, some member states count this item under reserves: France, Germany, Italy, Malta, the Netherlands and Spain.

---

[9] Austria, Denmark, Finland, Germany, Slovenia, Spain and Norway

[10] Dated silent partnerships have a minimum maturity of five years and are not taken into account during the last two years before maturity, although still sharing losses. Since dated silent partnerships fulfil all principles for eligibility apart from the quasi-permanence, they are accepted as core original own funds up to a limit of 50% but only for small or regional active banks. For internationally active banks Germany only recognises permanent silent partnerships up to a limit of 50%. In this case, dated silent partnerships with a minimum maturity of 10 years are counted as innovative capital within original own funds up to a limit of 15% and beyond this limit as core additional own funds.

Preference shares

26. The definition and features of a preference share may vary between member states, due to company laws.

27. The CRD excludes cumulative preference shares. By contrast, non-cumulative[11] preference shares are not explicitly mentioned. Therefore, some member states (Austria, Cyprus, Italy, Ireland, Hungary, Greece, the Netherlands, Portugal, Slovenia, Sweden and United Kingdom) have considered the latter to be implicitly included in core original own funds. The other member states have considered them as supplementary original own funds. See table page 33 below.

28. Where relevant, the limits applicable to preference shares, be they on the basis of the national company laws, or be they defined by competent authorities for prudential purposes, are summarised in the table page 33 below.

b. The same characteristics of capital are commonly used across Europe

29. Supervisors have derived from Article 61, second paragraph, the following common characteristics of capital. Capital must be:

1. issued,

2. fully paid-in,

3. permanent,

4. available to absorb losses on a going concern basis and under stress, therefore excluding cumulative instruments (part of additional own funds), and

5. must provide the institution with full discretion as to the amount and timing of distributions.

30. The BAC-GTIAD survey listed two other characteristics which should ideally be fulfilled for recognition as capital:

- ✓ the holders of the instruments (hereinafter also referred to as "shareholders") have direct (pro rata) ownership in the bank under law (ius-in-re); and
- ✓ shareholders´voting rights are attached to the instruments

31. On these last two characteristics, the situation varies across member states as company law in each member state determines the legal form of its business undertakings, the various types of capital and therefore the ways that direct ownership and voting rights are established. Moreover, this is not

[11] When a payment (or distribution) cannot be paid at a certain point in time, the shareholder definitely loses his right to receive the payment and the interest is not accrued.

a CRD requirement and the BAC-GTIAD survey did not see the absence of voting rights as sufficient grounds to disqualify capital from core original own funds.

c. In half of the member states, capital reduction is subject to prior supervisory approval

32. In Italy, Lithuania, Malta, the Netherlands and Norway the reduction of capital is subject to formal prior supervisory approval to make sure that such reduction does not significantly compromise the level and the quality of regulatory own funds and therefore the financial soundness of the institution. In Hungary, Portugal, Greece and Spain the supervisory authority, (the Ministry of Finance in Spain), must approve the change to the Articles of Association in a case of the reduction of the subscribed capital.

33. Although formal approval is not required in the United Kingdom, France, Ireland and Luxembourg, in practice an institution would redeem ordinary share capital only after discussion with the supervisory authority. In Slovenia no prior supervisory authorisation is required, but prior notification. The detailed information provided by each member state is set out in Annexes 3 and 4.

2. Reserves

a. Reserves, as defined in the Directives, are generally treated quite similarly across member states, differences in the types and denominations of legal and statutory reserves arising as the result of different national company laws

34. According to Article 57(b) of the recast Directive 2000/12/EC, reserves within the meaning of Article 23 of Directive 86/635/EEC and ‘profits and losses brought forward as a result of the application of the final profit or loss’, are eligible items for core original own funds.

35. Reserves may also include interim profits under a strict set of conditions.

36. The last paragraph of Article 57 excludes from the reserves, in the case of a credit institution which is the originator of a securitisation, net gains arising from the capitalisation of future income from the securitised assets and providing credit enhancement to positions in the securitisation.

37. Article 23 of Directive 86/635/EEC sets out that: “Liabilities: Item 11 – Reserves: This item shall comprise all the types of reserves listed in Article 9 of Directive 78/660/EEC under Liabilities item A.IV, as defined therein. The member states may also prescribe other types of reserves if necessary for credit institutions the legal structures of which are not covered by Directive 78/660/EEC. The types of accounting reserve referred to in the first paragraph shall be shown separately, as sub-items of Liabilities item 11, in the balance sheets of the credit institutions concerned, with the exception of the revaluation reserve which shall be shown under item 12.”

38. Article 9 Liabilities A.IV sets out the definition of the accounting reserves in Directive 78/660/EEC as follows:

    1. legal reserve, in so far as national law requires such a reserve;

    2. reserve for own shares, in so far as national law requires such a reserve, without prejudice to Article 22(1)(b) of Directive 77/91/EEC;

    3. reserve provided for by the Articles of Association; and

    4. other reserves.

39. Article 22(1)(b) of Directive 77/91/EEC states that where the laws of a Member State permit a company to acquire its own shares, either itself or through a person acting in his own name but on the company's behalf, they shall make the holding of these shares at all times subject to at least the following conditions: (…) if shares are included among the assets shown in the balance sheet, a reserve of the same amount, unavailable for distribution, shall be included among the liabilities.

40. All member states and Norway include reserves in core original own funds. Annex 4 provides the detailed national descriptions of these reserves.

b. Regardless of their legal and accounting definitions, reserves are included in core original own funds because of their ability to absorb losses and their permanence.

41. The main characteristics of reserves include the following:

    1. available to absorb losses on a going-concern basis; and

    2. permanence in the sense that they are not subject to covenants under law or contract. Permanence in this context means two things - firstly, that the reserves have no definite maturity and, secondly, that there is no conditional right to obtain a dividend from reserves.

Profits and losses brought forward as a result of the application of the final profit or loss

42. All member states include accumulated profits retained by the institutions after taking account of dividends and tax as displayed in the balance sheet in the last audited annual accounts for the end of a financial year.

43. A vast majority of member states reported that they require their institutions to adjust their financial results to take into account foreseeable dividends, i.e. to deduct them when calculating the regulatory own funds.

Interim profits

44. Article 57 paragraph 3 of the recast Directive 2000/12/EC states that member states may permit the inclusion of interim profits in reserves before they have been formally approved provided that the following requirements are met:

    - the interim profits shall have been verified by persons responsible for the auditing of the accounts and it shall have been proved to the

satisfaction of the competent authorities that the amount thereof has been evaluated in accordance with the principles set out in Directive 86/635/EEC (i.e. determined after accounting for all charges relating to the period and after the allocation of amortisation accounts, provisions and value adjustments); and

- the interim profit shall be net of any foreseeable charge or dividend.

45. Provided that these requirements are met, interim profits are included in core original own funds in most member states and Norway. In Slovakia, the inclusion of interim profits is not permitted. In Belgium interim profits are only eligible on a consolidated basis. In Lithuania interim profits qualify as an additional own funds element.

46. Like retained earnings, interim profits would be among the first items to absorb losses in the event of a deficit in the institution. Interim profits net of any foreseeable charge or dividend will usually be converted into retained earnings.

47. Although the CRD is not precise on what is meant by 'persons responsible for the auditing', most of the member states allowing interim profits as an eligible core original own funds element require the approval of the external auditors. In Italy, the internal auditor's verification is accepted only for non listed banks included in a banking group in which no banks are listed. In Greece semi annual interim profits need to be reviewed by external auditors. For IFRS banks, in which prudential filters are applicable, interim profits other than semi annual may also be verified by internal auditors.

48. Most member states seem to interpret "verified" as a 'review engagement[12]' and not a full audit as required by company law and approved by the General Assembly for the end-of-year profit. The auditor's report is often required to be submitted to the supervisory authorities.

49. There are some differences with regard to the way in which foreseeable charges and dividends are calculated and taken into account. Among foreseeable charges to be deducted, taxes are usually mentioned. Most member states deduct foreseeable dividends, although the way they are calculated may differ across member states. Further details on specific treatments by member states can be found in Annex 5.

50. Some specific conditions for inclusion can also be found. Germany requires that an institution which assigns interim profits to its core capital must draw up a set of interim accounts for at least five years. Interim profits are included into original own funds subject to supervisory approval in Ireland and Latvia.

[12] The objective of a review engagement is to enable the auditor to state whether, on the basis of procedures which do not provide all the evidence that would be required in an audit, anything has come to the auditor's attention that causes the auditor to believe that the financial statements are not prepared, in all material respects, in accordance with an identified financial reporting framework.

3. Funds for general banking risks

a. Not all member states have exercised the option to include funds for general banking risks in original own funds

51. Article 57(c) of the recast Directive 2000/12/EC lists funds for general banking risks within the meaning of Article 38 of Directive 86/635/EEC as eligible for core original own funds. Article 38 of Directive 86/635/EEC states that 'Pending subsequent coordination, those Member States which exercise the option provided for in Article 37 must permit and those Member States which do not exercise that option may permit the introduction of a Liabilities item 6A entitled 'Fund for general banking risks'. That item 'shall include those amounts which a credit institution decides to put aside to cover such risks where that is required by the particular risks associated with banking'. Furthermore, 'the net balance of the increases and decreases of the 'Fund for general banking risks' must be shown separately in the profit and loss account.'

52. Funds for general banking risks include certain amounts set aside for future losses and other unforeseeable risks on the basis of requirements or allowed by local circumstances or legislation.

53. Currently funds for general banking risks are eligible for original own funds in thirteen member states[13]. Five (France, Luxembourg, Netherlands, Portugal and Greece) specified that they use a dual system so that institutions that operate under national GAAP may include the funds for general banking risks and those institutions operating under IAS/IFRS must transfer the amount into reserves. In Spain, the funds for general banking risks are only eligible for the amount within the balance sheet and, thus, eligible at the entry into force of IAS/IFRS.

54. Ten member states[14] and Norway do not allow for inclusion of funds for general banking risks in original own funds among which four (Cyprus, Italy, Slovenia and Czech Republic) stated that the item was not acceptable because of the general application of IAS/IFRS by their institutions.

55. In Sweden domestic institutions are not allowed to include funds for general banking risks within their original own funds. The item can however be included in the consolidated original own funds of Swedish institutions if this item is deemed eligible by other national supervisors of entities in the group.

56. In Malta and in Poland funds for general banking risks are classified as additional own funds for the moment. The Maltese authorities however intend to introduce the item "regulatory reserve" into the components of own funds in order to be in conformity with IAS 39 and EU directives.

---

[13] Austria, Belgium, France, Germany, Greece, Hungary, Latvia, Lithuania, Luxembourg, Netherlands, Portugal, Poland and Spain

[14] Cyprus, Czech Republic, Denmark, Estonia, Finland, Ireland, Italy, Slovakia, Slovenia, United Kingdom

b. The introduction of IAS/IFRS has led to the transfer of funds for general banking risks to the category of reserves.

57. According to IAS/IFRS, the setting aside of amounts in respect of general banking risks is not an expense but an appropriation of retained earnings, and as such, a transfer to reserves (whereas according to Article 38 of Directive 86/635/EEC, the increase and decrease in such amounts must be recognised in the profit and loss account). Therefore, amounts formerly shown as funds for general banking risks are no longer considered as 'provisions' but must be transferred to the reserves.[15]

4. Adjustments due to the revaluation effects introduced by the application of IAS/IFRS

58. The introduction of IAS/IFRS has been a source of concern to supervisory authorities, notably because of fears that these standards could jeopardise the criteria that regulatory own funds have to fulfil.

59. There were also some concerns that, due to the fact that more assets and liabilities can or shall be valued at fair value, IAS/IFRS could introduce volatility into institutions' financial statements and, more particularly, into regulatory own funds, in ways which might not reflect the economic substance of institutions' financial positions.

60. In order to preserve the definition and maintain the quality of regulatory capital, CEBS developed Guidelines on prudential filters[16] for regulatory capital. The filters have been designed to adjust regulatory own funds for some changes appearing in the (accounting) equity of institutions that apply IAS/IFRS (or national generally accepted accounting principles (GAAP) that are similar to IAS/IFRS) for prudential purposes.

61. In broad terms, losses which relate to negative valuation differences on the assets listed below should be deducted from core original own funds.

62. When the valuation differences on the assets listed below generate a positive value, they can be included in additional own funds. Unrealised gains are included in additional own funds and not in original own funds because they are considered as "less permanent". Also because they are not realised, they cannot be considered to be immediately available. (See Section 2.2, point 2 below).

63. More specifically, CEBS recommends that

-with regard to fair value revaluation reserves on equities available for sale, unrealised losses should be deducted from original own funds for the amount after tax. Unrealised gains should only partially be included in additional own funds. Partially means that at least the tax effect should be taken into account;

---

[15] The transition adjustment to IAS/IFRS is made against Reserves/Retained earnings, as stated by IAS/IFRS

[16] See http://www.c-ebs.org/Advice/prudential_filters.htm

-with regard to the fair value revaluation reserves on loans and receivables available for sale, the unrealised gains and losses, apart from those related to impairment, should be neutralised (i.e. excluded from) in own funds for the amount after tax. For other assets available for sale (e.g. debt securities), one of the two treatments (either for loans or for equities) should be applied.

64. In line with CEBS guidelines, member states may also wish to consider the need for transitional arrangements to address the impact of the first time application of IAS/IFRS. In this context, some member states partially reintegrate into original own funds the impact related to the post employment obligations.

65. In accordance with CEBS guidelines, unrealised gains on investment properties should be deducted from core original own funds (profit and loss account) and partially included in additional own funds.

66. Two other CEBS prudential filters are already introduced in the CRD. Article 64(4) states that "Institutions shall not include in own funds either the fair value reserves related to gains and losses on cash flow hedges of financial instruments measured at amortised cost, or any gains or losses on their liabilities valued at fair value that are due to changes in the credit institutions' own credit standing."

67. CEBS experts carried out an internal study early 2005. Answers from eighteen countries[17], based on issued or draft regulations, were received and included in the analysis. This preliminary and broad-brush study showed that CEBS recommendations had favoured a homogenous application of prudential filters across Europe. However, a certain variety of prudential treatments remained in some areas (see paragraphs 165 to 167 below)

68. The study showed that CEBS recommendations on assets available for sale have been applied by a large number of respondents (from 13 to 16 out of 18) as far as equities, loans and receivables and other available for sale assets (categories subjected to different prudential filters) are concerned. The same conclusion could be reached on cash flow hedges, funds for general banking risks and deferred tax assets[18].

69. CEBS continues to monitor how the prudential filters are or will be implemented by national competent authorities.

70. A full assessment of the impact of IAS/IFRS on regulatory own funds is premature as some of the international accounting standards (or some of their provisions) have only recently been endorsed at EU level and thus may have further effects on credit institutions' accounting and capital figures. Institutions, as well as supervisors, are still very much in a learning process

---

[17] Belgium, Cyprus, Czech Republic, Estonia, Finland, France, Greece, Ireland, Italy, Latvia, Lithuania, Luxembourg, Netherlands, Norway, Portugal, Slovakia, Spain and United Kingdom. Austria, Denmark and Germany, indicated that they did not apply the IFRS for their prudential returns. The three remaining member states did not participate.

[18] On deferred tax assets, CEBS recommendation is to keep current prudential treatments.

when it comes to the application of IAS/IFRS. However, a preliminary assessment[19], based on a sample of EU countries has been carried out by CEBS and it has indicated that the overall reduction in regulatory own funds is largely due to the reduction of reserves as a consequence of the first-time application of IAS/IFRS.

71. The overall effect of the transition to IAS/IFRS and of the application of the prudential filters results in a moderate decrease in 'Total Eligible Own Funds'. The effect on regulatory own funds would have been stronger without the application of prudential filters to IAS/IFRS equity elements. The prudential filters contribute to an upward correction of regulatory own funds that, apart from the neutralisation of the reclassification effect (arising from the fact that in accordance with CEBS guidelines, preference shares held by third parties that are reclassified from equity to debt under IAS/IFRS, continue to be included in regulatory own funds), is due mainly to the fact that 'Fair Value Revaluation Reserves' are included, even if partially, in additional own funds.

5. The calculation of core original own funds

72. In accordance with Article 66 and Article 57(i) to (k) of the recast Directive 2000/12/EC the following items shall be deducted from the original own funds of an institution:

    (i) own shares at book value held by the credit institution;

    (j) intangible assets within the meaning of Article 4(9) (Assets) of Directive 86/635/EEC;

    (k) material losses of the current financial year.

73. Article 4(9) of Directive 86/635/EEC defines intangible assets as assets described under Assets headings B and C.I of Article 9 of Directive 78/660/EEC, showing separately:

    - formation expenses, as defined by national law and in so far as national law permits them to be shown as an asset (unless national law requires their disclosure in the notes on the accounts); and

    - goodwill, to the extent that it was acquired for valuable consideration (unless national law requires its disclosure in the notes to the accounts).

74. According to Directive 78/660/EEC intangible assets are:

    1. costs of research and development, in so far as national law permits them to be shown as assets;

    2. concessions, patents, licences, trade marks and similar rights and assets, if they were;

    (a) acquired for valuable consideration and need not be shown under C (I) (3); or

[19] See further details on http://www.c-ebs.org/press/14022006.pdf

(b) created by the undertaking itself, in so far as national law permits them to be shown as assets;

3. goodwill, to the extent that it was acquired for valuable consideration; and

4. payments on account.

a. There is a high degree of commonality on the way the deductions set out in the CRD are to be made

75. According to the answers received in the stock take, all member states require the deduction from original own funds of own shares, intangible assets (including goodwill) and material losses for the current year. In all member states, any losses that occur are deducted from core original own funds: not only interim and material losses but all the losses of the current year and losses brought forward from previous years.

76. Own shares are deducted, either explicitly or implicitly. In Austria, Germany and Hungary own shares are not taken into account during the calculation of subscribed capital right from the start (application of net calculation), while in Denmark own shares are valued at zero. In Cyprus, institutions are not allowed to hold or trade their own shares.

77. With the introduction of IAS/IFRS, the definition of intangible assets may be broader, i.e. including the so-called 'new intangibles'. Moreover, the method of valuation of intangible assets could raise additional questions, but those were not within the scope of this survey but rather showed a close connection with the issue of the application of IAS/IFRS standards. Empirically it is noted that in some member states using IAS/IFRS, intangibles are still valued by local GAAP and, vice versa, in some cases intangible assets are valued as required by IAS/IFRS standards in those member states in which accounting in general is carried out according to local GAAP. Although most member states using IAS/IFRS deduct intangible assets valued according to IAS/IFRS for the purpose of the calculation of regulatory own funds, some member states allow the intangibles to be valued and deducted according to local GAAP.

b. Several member states deduct other items in addition to those listed in the CRD

78. Article 61 allows member states to deduct items other than those listed in the CRD. Several member states make use of this option.

79. In Norway, Sweden and Denmark deferred tax assets are required to be deducted from original own funds. The rationale behind this is that their values are dependent on future income.

80. Negative net pension liabilities (Asset) or some components of the defined benefit pension liability are also commonly deducted, e.g. in France, Portugal and Norway. These assets are not realisable and their values are dependent on a potential reduction in future pension costs. In the case of the winding up of an institution post-employment benefits to the employees generally belong to the pension scheme and not to the credit institution itself.

81. Loans to the owners (Germany) or to third parties whose object is the acquisition of shares, contributions or other securities eligible as own funds of the credit institution itself or of another institution belonging to the consolidated group, or own shares held by non-consolidated enterprises within the group (Spain), shall also be deducted from original own funds in these two respective countries. Lending of a capital nature to group companies, both consolidated and unconsolidated, is deducted from own funds in Cyprus.

82. In Italy, France and Ireland, provisions written in general terms allow the supervisory authority to require the deduction, on a case-by-case basis, of any elements which are potentially able to reduce original own funds. In Greece, any shortfall of provisions based on accounting rules compared to provisions calculated for regulatory purposes is deducted 50% from original own funds and 50% from total own funds.

83. Annex 6 provides further details on member states' treatments.

6. The calculation of core original own funds on a consolidated basis

a. The elements of consolidated reserves listed by the CRD are taken into account differently

84. Article 65(1) of the CRD states that when they are credit («negative») items, the following items may be regarded as consolidated reserves for the calculation of own funds. When they are debit («positive») items, they shall be deducted in the calculation of consolidated own funds:

    (a) any minority interests within the meaning of Article 21 of Directive 83/349/EEC, where the global integration method is used;

    (b) the first consolidation difference[20] within the meaning of Articles 19, 30 and 31 of Directive 83/349/EEC;

    (c) the translation differences included in consolidated reserves in accordance with Article 39(6) of Directive 86/635/EEC; and

    (d) any difference resulting from the inclusion of certain participating interests in accordance with the method[21] prescribed in Article 33 of Directive 83/349/EEC.

85. According to Article 21 of Directive 83/349/EEC minority interest is defined as the amount attributable to shares in subsidiary undertakings included in the consolidation held by persons other than the undertakings included in the consolidation.

---

[20] The first consolidation difference results from translation differences at the date at which undertakings are included in the consolidation for the first time

[21] The "equity method" is used in the case of certain participating interests which are not consolidated by applying either the full or the proportional consolidation method

86. Member states reported some specific features with regard to the treatment of minority interests. As an illustration, Belgium indicated that the competent authority may exclude minority interests from original own funds if they are not bearing risks and cannot be used effectively to cover losses.

87. In the Netherlands third-party interests are counted except in cases of significant overcapitalisation of a participating interest, judged on a case-by-case basis. In Italy minority interest of ancillary companies (like companies created for spin-offs) are included in consolidated own funds only up to the additional capital requirement related to the risk weighted assets of the companies themselves.

88. Spain includes within minority interests non-cumulative non-voting shares, loan capital of indeterminate duration and preferred stock issued by foreign subsidiaries which fulfil a strict set of conditions, the amount of minority interests is broken down within the different tiers of capital taking into account the eligibility of the instrument which originates the minority interests. In France minority interests are eligible for consolidated original own funds up to a limit of 25% of original own funds. In Estonia minority holdings arising from preference shares are not eligible for consolidated reserves. In the United Kingdom minority interests, arising as a result of the consolidation of a subsidiary with preference shares, may only be permitted as core original own funds if the preference shares themselves would also be eligible to qualify as core original own funds. Please refer to Annex 7 for further details.

89. Under Article 39(6) of Directive 86/635/EEC member states may require or permit translation differences arising on consolidation out of the retranslation of an affiliated undertaking's capital and reserves or the share of a participating interest's capital and reserves at the beginning of the accounting period to be included, in whole or in part, in consolidated reserves, together with translation differences arising on the translation of any transactions undertaken to cover such capital and reserves.

90. Differences arising from consolidation by the equity method do not qualify as capital on a consolidated basis in the Czech Republic, Denmark, Germany, Latvia, Lithuania, and Poland. In Norway, the use of the equity method is not allowed for the calculation of regulatory capital on a consolidated basis. Please refer to Annexes 4 and 7 for further details.

b. The calculation of own funds on a consolidated basis has been impacted by the introduction of IAS/IFRS

91. According to IAS 21 (the standard that regulates the effect of changes in foreign exchange rates) translation differences arising during consolidation are included among reserves for foreign exchange conversion.

92. Another significant difference is that according to IAS/IFRS negative goodwill on an acquisition is recognised immediately in the profit and loss account as an item of retained earnings in consolidated original own funds. Differences arising from consolidation by the equity method are also valued directly during the calculation of core original own funds. Negative equity method

participations, foreign currency holdings' translation reserves and minority interests are included in consolidated original own funds.

Section 1.2. Supplementary original own funds

93. Capital-raising instruments have recently been created by institutions to raise funds in a cost-efficient and less dilutive way and have been designed to be included in eligible regulatory original own funds. Moreover, while common shares must be issued in the currency of the country in which an institution is incorporated, the issuance of preference securities, via for instance Special Purpose Vehicles (SPVs), allows an institution operating outside its country of incorporation to raise capital in foreign currency and match them against its assets denominated in this foreign currency.

94. On 27 October 1998, the Basel Committee issued a press release[22] which set out the conditions for these instruments to be considered as regulatory original own funds while imposing limits on their inclusion. This aimed to set out a framework to help supervisors base their approach towards these instruments in a consistent way, and consequently ensure a level playing field among internationally active institutions. It produced the first guidelines for the acceptance of hybrids as original own funds based on features like permanence or loss absorption capacity.

95. In Europe, in the absence of an EU-wide legal text and due to an ever-increasing variety of instruments, competent authorities did not try to list potentially eligible items but built on their assessment of hybrids' eligibility for original own funds on the Basel press release, or on qualitative requirements that are very similar or complementary to the latter.

96. Although the features attached to these instruments differ, and therefore their definition and the limits to the inclusion of such instruments in original own funds may vary across member states, the BAC-GTIAD Survey started to add some clarity by putting them together under a category named 'supplementary original own funds'.

97. Supplementary original own funds are different to core original own funds as they are endowed with features that weaken the indicators mentioned above, e.g. their permanence and their loss-absorption, compared to the capital and reserves.

98. However, supplementary original own funds usually possess all the following characteristics that differentiate them from additional own funds: no maturity, ranking senior only to ordinary shares, non cumulative payments, coupons or dividends at the issuer's discretion in order to absorb losses on an on-going basis and in periods of stress.

99. This section does not aim to set out a common list of eligible hybrid instruments to be original own funds but rather elaborates on the common

---

[22] www.bis.org/press/p981027.htm

criteria against which these instruments are assessed. Annex 8 sets out in more detail the main types of instruments member states have been confronted with together with their main features.

1. Supplementary original own funds encompass a wide range of instruments

100. Various types of hybrids have been included in original own funds. The most commonly used types are preferred shares and preferred securities/ subordinated debt instruments. They may be either directly issued or issued through SPVs, and may or may not be convertible. In several member states, asset contributions by major partners or associates are also considered to be part of supplementary original own funds. They take the form of silent partners' contributions in Germany (also recognised by the Luxembourg supervisor), "associés en participation" in Luxembourg, and "Participaciones preferentes" issued only to institutional investors in Spain.

101. The Basel press release introduced a qualitative distinction between different components of Tier 1/original own funds. This text stated that "voting common shareholders' equity and disclosed reserves or retained earnings that accrue to the shareholders' benefit should be the predominant form of a bank's Tier 1 capital". The reasons provided for this guideline are the following:

- common shareholders' funds allow a bank to absorb losses on an ongoing basis and are permanently available for this purpose;
- these elements of capital best allow banks to conserve resources when they are under stress because they provide a bank with full discretion as to the amount and timing of distributions; and
- the voting rights attached to common stock also provide an important source of market discipline over a bank's management.

102. Capital and reserves have been addressed in Section 1.1 above, "core original own funds".

103. Some member states exclude preferred shares from core original own funds on the basis that the discretion over payment is weakened compared to an ordinary share. The holder of a preferred share renounces the voting right attached to an ordinary share in compensation for preference rights to dividends. Moreover, given the highly leveraged nature of some institutions and their reliance on the capital markets for funding, it seems, in effect, extremely difficult for an institution to defer a dividend payment on a preferred share and survive on a going-concern basis as an independent entity. However, the member states which include preferred shares in core original own funds consider their equity content sufficient with regard to specific local company laws to make them eligible for the highest quality part of original own funds.

104. The EU legislation is silent on the regulatory treatment of these instruments: the CRD only states that cumulative perpetual preference shares

are excluded from capital and original own funds. However, there is no specification on the treatment (i.e. inclusion and limitation) of non cumulative perpetual preference shares in original own funds or about other forms of capital instrument.

105. In all member states, hybrids must be issued and fully paid to be taken into consideration in the calculation of own funds. Prior supervisory authorisation is required in all member states[23] apart from five (Austria, Denmark, Germany where a check by external auditor is instead required, Hungary and Malta where it is compulsory only for capital instruments including step-up).

106. Quite a few member states[24] allow both direct and indirect issuance through SPVs, depending of the type of instrument. Preferred securities are often indirectly issued as the Anglo-Saxon markets were the originators of these types of product. In the case of indirect issuance, hybrids are included in original own funds as minority interests. Mechanisms which ensure that the proceeds are immediately available without limitation are commonly requested (see below: Loss absorbency criteria). Direct issuance is mandatory in Cyprus for capital instruments with step-up.

107. The accounting treatment seems to vary under IAS/IFRS and national regulation. Mostly hybrids are considered as equity or liabilities under national laws and as equity under IAS/IFRS. Coupons or dividends are mainly deductible for tax[25]. Three member states (France, Italy and Ireland) indicated that indirectly issued hybrids, like preferred securities or shares, are tax deductible whereas dividends are not deductible when these instruments are directly issued.

108. Issues must meet disclosure requirements in most member states[26]

109. Regardless of their form (securities, notes etc), hybrids are designed according to and assessed by the market and the supervisors against three key criteria: permanence, loss absorption capacity and flexibility of ongoing payments. These criteria are specified in more and more standardised clauses in the term sheet of issues. They are:

- permanence: the capital instrument should be permanently available so that there is no doubt that it can support depositors in times of stress;
- loss absorption capacity: the instrument should be deeply subordinated making it available to absorb losses, both on a going-concern basis and in liquidation, and to provide support for depositors' funds if necessary; and

[23]Ireland, United Kingdom, Luxembourg, France, Spain, Greece, Portugal, Netherlands, Belgium, Sweden, Italy, Finland, Norway, Slovenia and Cyprus
[24]Ireland, Austria, France, Spain, Portugal, Netherlands, Belgium, Sweden and Germany. In Denmark and Slovenia, only direct issues are permitted
[25]United Kingdom for instruments in the 15% limit on Tier 1, Luxembourg, France, Spain, Netherlands, Sweden, Italy, Finland, Denmark, Norway, Slovenia, Cyprus and Germany
[26]Ireland, Luxembourg, France, Spain, Germany, Greece, Portugal, Belgium, Italy, Finland, Norway, Slovenia, Cyprus, Austria and Netherlands

- flexibility of on-going payments: the instrument must contain features permitting the non-cumulative cessation of payment of coupons or dividends in times of stress.

2. National competent authorities assess supplementary original own funds against three key eligibility criteria

a. The vast majority of hybrids included in original own funds are structured to be permanent

110. The vast majority of hybrids included in original own funds are explicitly undated. Conceptually therefore, in most countries, the fact that these instruments are structured as perpetuals satisfies the permanency test, that is the ability to support the bank's operations on an on-going basis. A very limited number of member states (e.g. Germany, Luxembourg and Netherlands) accept dated issues, which constitutes a departure from this principle. Please refer to Annex 8 for further details on these issues.

111. Based on the fact that most hybrids are undated, there is no requirement for the amount recognised as original own funds to be amortised over the life of the instrument. The only exception to this approach is that dated instruments issued in Germany (silent partnerships) are eligible as original own funds except in the last two years before redemption (cf. footnote 10).

112. Despite their perpetual character however, in most member states hybrids contain redemption features which provide the issuer with the option to call (associated with or without a step-up) the issue after a period of five years or more. The exercise of the call is at the discretion of the issuer but in all cases subject to prior supervisory approval. Before granting authorization to redeem, competent authorities carefully analyse the financial soundness and solvency of the institution and may require that the redeemed hybrids are replaced with capital of at least "equivalent" quality.

113. In addition, some hybrids contain a single coupon step up 10 years after the issue date. The step ups are usually 100 bp over the initial rate or 50% of the initial re-offer margin. They are capped at the above limit, as the higher the step up the greater the presumption that the instruments will be redeemed at the first call date. This type of hybrid is almost always limited to 15% of original own funds in line with the Basel press release.

114. It can be argued that the coupon step up dates effectively act as implicit maturity dates as they provide investors with confidence that the issue will be redeemed after a period of ten years as issuers have a strong incentive to call the issues to avoid excessive costs stemming from stepped up coupon payments.

115. It is worth mentioning though that the new trend in the market for capital instruments is focused on the issue of the so called "non-innovative" instruments which do not include a step up clause. These new instruments are mainly structured products where the payments are linked to swap market yields. Such instruments are generally known as CMS-linked.

116. Most of the member states which include non-innovative instruments in original own funds have set higher thresholds compared to instruments with step-up because they are less likely to be redeemed at the first call date. More precisely, in the case of institutions that have in the past issued capital instruments without step-ups, eligibility limits range from 15% to 50% of total original own funds (see table page 33).

117. With regard to early redemption clauses, in most member states early redemption is triggered by an event such as a change in regulatory recognition of hybrids or a change in the tax treatment of these instruments, subject to prior consent having been obtained from the supervisory authorities.

118. In a very limited number of member states (United Kingdom and Italy), innovative instruments may include features that create incentives for early calls such as a bonus coupon instead of a step up at the first call date or they may be called earlier with the agreement of the supervisory authorities. It is also noted that stock settlement features are permitted in a few cases e.g. in Malta and the United Kingdom, a feature that may weaken the permanence of such instruments. In particular when the issuance of new ordinary shares is required, it is very probable that the issuer will exercise its call option in order to avoid the dilution of ordinary shareholders.

b. Loss absorption both on a going concern basis and in liquidation is so essential that capital hybrids which do not fulfil this criterion do not qualify as original own funds in any country

119. Loss absorption is so essential that hybrids which do not fulfil this criterion do not qualify as original own funds in any country. The ability of hybrids to absorb losses is required both on a going concern basis and in liquidation. Loss absorption on a going concern basis means that an institution is able to incur a loss and remain solvent even if distributable reserves have been depleted. If an instrument has no or little ability to assist a bank to trade in situations of stress, it is closer to subordinated debt and would be disqualified from original own funds.

120. In this respect, a subordination clause is a prerequisite for recognition as original own funds by regulators. This clause typically specifies that hybrids are junior to depositors and other creditors, as well as subordinated debt holders. This means that in the event of the issuing bank being wound up these instruments would rank senior only to ordinary shares and pari passu with similar instruments (including most non-cumulative preferred shares).

121. All member states require that hybrids should not be secured or covered by a guarantee granted by the issuer or a related entity in a way that would legally or economically enhance the seniority of the claim.

122. In the majority of member states hybrids shall or may be, depending on the country, replaced by an equivalent or higher quality original own funds instrument (i.e. ordinary shares and for Ireland only preference shares) in

specific cases, e.g. in case of a capital deficiency or when the market price exceeds a predetermined level or in the case of an institution's winding up.

123. A loss absorption clause to ensure the ability of hybrid to absorb losses on an on-going basis is always required, without though, in most countries, the prerequisite for a legal opinion on such a clause.

124. The main mechanisms which ensure hybrids' loss absorbency are:

1. proceeds are immediately available without limitation to the issuing institution (direct issuance). If proceeds are immediately and fully available only to the issuing SPV (indirect issuance), then the proceeds are made available to the institution (e.g. through conversion into a directly issued instrument, that may be of higher quality or the same quality or the same quality and the same terms) at a predetermined trigger point, well before a serious deterioration in the institution's financial position arises;

2. the institution has (i) discretion over the amount and timing of distributions, subject only to a prior waiver of distributions on the institution's common stock and (ii) full access to waived payments;

3. distributions can only be paid out of distributable items; when distributions are pre-set they shall not be reset based on the credit standing of the issuer;

4. resources are conserved in periods of stress (non cumulative instruments); and

5. payments are prioritised in the context of a winding up so that hybrids' holders rank senior only to ordinary shareholders.

125. Most commonly, the dividends on hybrid capital instruments are not paid if certain supervisory events occur, such as (i) losses in the current year by the parent institution or any other subsidiary, (ii) breach of solvency ratio, (iii) original own funds ratio is less than a certain level (for example 5%), (iv) evidence of deterioration in the institution's financial condition,(v) the surplus over the minimum capital requirement falls below a certain amount, or (vi) the institution has not declared nor paid dividends to ordinary shareholders.

126. In all member states, the proceeds of hybrids issued must be available to the issuing/parent institution for the coverage of risks and losses on an on-going basis and prior to the initiation of an insolvency procedure.

127. In cases of indirect issue, the issuing SPV is usually a group company and the proceeds are transferred to the parent institution by means of a subordinated inter-company loan or deposit. The latter constitutes an unsecured obligation of the institution and ranks junior in right of payment to all present and future senior indebtedness of the institution i.e. in the event of the initiation of insolvency proceedings, these instruments will not be repaid until all creditors (including subordinated debt holders) have been satisfied.

128. Additionally, the funding of the SPV, in some member states, is automatically cancelled if a trigger event is activated and the institution's obligations to pay interest and principal are extinguished. Consequently, the subordinated loan/deposit which was a liability item in the financial statements is cancelled out and an almost equivalent profit is transferred to Equity through retained earnings.

129. Some member states require the nominal amount of the hybrid notes, commonly issued directly, to be written down in times of stress. It follows from this treatment that dividend or coupon payments to holders of the instrument effectively decrease.

130. To ensure the loss absorbency on an on-going basis dividend or coupon payments are deferred and the nominal amount of hybrids may be written down when losses are significant or retained earnings exhausted. However, a 'return to profitability' provision is generally accepted: the nominal can be increased back to its amount at issue if the institution has recorded positive consolidated net income for the latest fiscal year following the end of the supervisory event.

131. Due to the conditional write-down clauses and the fact that hybrids often are not written down until all or a substantial part of the share capital is lost, hybrids may in some cases be less suitable for covering losses or deficits on a going-concern basis. Except for payments of coupons being waived, hybrids would often cover losses or deficits on a going concern basis for a short interim period only. In a refinancing situation, the writing-up clauses of hybrids and the fact that more groups take part in the negotiations may make it more difficult to attract new capital and avoid a winding up of the institution, with the systemic implications this could have.

c. Institutions must have full flexibility of on-going payments

132. In all member states coupons must be non-cumulative if payment is in cash. The United Kingdom, Belgium and Malta make a distinction between coupons paid in cash and coupons paid by issues of another original own funds instrument (most commonly ordinary or preference shares). In these countries such a supplementary original own funds instrument can be cumulative. In the case of a coupon deferral it may be paid by means of stock at a future date. This feature is allowed on the grounds that there is no depletion of capital if a deferred stock is paid either directly in another original own funds instrument or from the proceeds of the sale of an equivalent instrument.

133. In all member states, institutions must be able to waive payments of the coupons under certain circumstances, either mandatorily or optionally. Such circumstances can be for instance a breach of its minimum capital requirement, lack of available distributable profits, occurrence of losses, or if capital falls below a certain level compared to minimum requirements. In most member states, coupon payments become mandatory if these conditions have not been breached.

134. Some member states such as the United Kingdom, France and Ireland, require the institution to have full discretion over coupon payments, not only under specific circumstances but at all times. In the case of the United Kingdom, the institution must have complete discretion over coupon payments made in cash but not coupons paid in the form of another original own funds instrument. In the case of France, the institution must have complete discretion over coupon payments, with the only exception of the payment due to the presence of dividend pushers.

135. A dividend stopper is a feature which prevents an institution making a dividend payment on a junior security, typically an ordinary share, when it withholds a dividend on a senior ranking security such as an innovative instrument. Dividend stoppers are permitted in most member states.

136. A dividend pusher is a feature which obliges the institution to pay a coupon on a more senior security, such as supplementary original own funds hybrids, if it has made a payment on junior ranking share capital. Dividend pushers are allowed by most member states. However, they are specifically disallowed in the United Kingdom and Malta, on the grounds that this feature denies the issuer's ability to waive or defer payments on the senior security.

137. Annex 8 provides further details on the assessment by national authorities of other mechanisms related to the flexibility of payments such as alternative coupon satisfaction mechanisms or scrip coupon payments.

3. Differences between a core additional own funds instrument and a supplementary original own funds instrument

138. A higher degree of loss absorption is, besides permanence, the key element which distinguishes supplementary original own funds from core additional own funds. The main features of core additional own funds instruments that are different from those of supplementary original own funds are summarized below:

- coupons are deferrable but cumulative which effectively limits the loss absorbency of the instruments particularly in times of stress. In some countries, the requirement that coupons will be non-cash cumulative is the only feature that differentiates supplementary original own funds from core additional own funds;
- the holders of these instruments with respect to the priority of payments rank below all creditors and senior to shareholders (preference and ordinary shares) and holders of hybrids;
- instruments may have soft maturities (over 30 years) and in some cases may also be amortised; and
- coupon step ups may be set over the limits specified in the Basel press release and take place after a minimum of 5 years with supervisory approval instead of 10 years according to the Press release.

4. Supervisors have included hybrids in original own funds subject to different limits

139. The Basel press release led to diverse interpretations among member states. It clearly fixed a 15% limit for hybrids with step-up but it did not fix an explicit limit for hybrids without step-up. The principle that "voting common shareholders' equity and the disclosed reserves or retained earnings that accrued to the shareholders' benefit should be the 'predominant' form of a bank's Tier 1 capital", could be interpreted as core Tier 1 should represent the majority, i.e. more than 50% of the total amount of Tier 1 (e.g. in Slovenia, the United Kingdom and the Netherlands) therefore recognising hybrids as eligible for up to 50% of the total of original own funds.

140. Many member states have established a distinction between two categories of hybrids with different limits in original own funds. The difference is based on the extent of the "equity like" quality of the hybrid instruments or preferred securities, meaning that the features of a high quality capital instrument should be very close to those of common shares. Instruments with the lowest equity content are often called 'innovative' and instruments with the highest equity content 'non innovative' although innovation is mostly concentrated nowadays on this second category of capital instruments.

141. Several member states[27] reported that they treat differently capital instruments with step-up and capital instruments without step-up. The dividing line is drawn on the incentive features to redeem the instrument (calls or step-up); although this feature is diversely taken into account by the different member states. Some additional features can also be used to characterise capital instruments of reduced quality.

142. A very limited number of member states (Cyprus, Denmark, Hungary, Italy, Luxembourg and Portugal) and Norway make no distinction among capital instruments i.e. they apply the same limit for hybrids and preferred securities with or without step-up or other call options that could create an incentive for early redemption.

143. All but Portugal stick to the 15% limit of the Basel press release. Portugal has fixed a higher limit of 20%.

144. In all the other member states, two sets of limits apply:

- 15% of original own funds for capital instruments with an incentive to redeem;

- up to 50% for the other hybrids.

145. The member states that set the highest limits consider that core original own funds should represent the predominant part, interpreted as the majority, of the total of original own funds.

[27] United Kingdom, Austria, Germany, France, Greece, Finland, Malta, Slovenia and Sweden

	Supervisory Limit on innovative (hybrids with step-up)	Supervisory Limit on hybrids excluding non cumulative preference shares (pref. shares are defined under national company law)	Limit on non cumulative preference shares as defined under national company law [1]
	Non additive limits		
Austria	15%	30%	50% [2][10]
Belgium	15%	33%	33% [8]
Cyprus	15%	15%	no limit [2]
Czech Republic	nr	nr	nr
Denmark	15%	15%	nr
Estonia	nr	nr	nr
Finland	15%	33% [3]	50% [4]
France	15%	25% [5]	nr [6]
Germany	15%	50%	nr
Greece	15%	30% [7]	no limit [2][4]
Hungary	nr	15%	no limit [2]
Ireland	15%	50%	no limit [2]
Italy	15%	15%	50% [2] [9]
Latvia	nr	nr	nr
Lithuania	no issuance	no issuance	33% [8]
Luxembourg	15%	15%	nr
Malta	15%	nr	nr
Netherlands	15%	50%	50%
Norway	15%	15%	no issuance
Poland	nr	nr	nr
Portugal	20%	20%	50% [2] [4] [10]
Slovakia	nr	nr	nr
Slovenia	15%	15%	49%[2]
Spain	15%	30%	30%
Sweden	15%	15%	no limit [2]
UK	15%	15%	50% [2]

nr=not recognised

[1] Excluding preference securities issued by SPV.
The definition and features of a preference share may vary between member states.
[2] Preference shares issued under national company law are considered as core original own funds
[3] 15% since december 2005
[4] Issuance by banks is unusual
[5] The 25% limit apply also on minority interests, even if they do not come from indirect issuance of hybrids
[6] No issuance so far
[7] 10% for innovative and 25% for any hybrid since 2006
[8] National Company laws provides this limit in percentage of the total of ordinary capital but banks have not yet issued any
[9] Limit applicable to listed institutions only and stated in percentage of total of ordinary capital, in the National company law
[10] limit stated in the national company law; calculated in percentage of total of ordinary capital

146. Complementary limits have been established in a handful of member states. Annex 8 provides the detailed information.

147. The amount of capital instruments in excess of the limits are eligible, within the regulatory limits, to be included as additional own funds in most member states.

CHAPTER 2: ADDITIONAL OWN FUNDS

148. Additional own funds include capital elements that do not have the same strength as original own funds.

149. For instance, eligible subordinated capital instruments are cumulative, which limits their ability to absorb losses in period of stress. They are undated (although some member states include dated instruments) but may contain redemption clauses and are less permanent than original own funds. They rank senior to original own funds. As a consequence, they are subject to limitations.

150. The CRD sets out five conditions which aim to ensure a certain degree of permanence, loss absorption and flexibility of payments for additional own funds**.**

151. Additional own funds can be divided into two main groups of items: (1) core additional own funds and (2) supplementary additional own funds.

152. According to limits laid down in Article 66 of the CRD, additional own funds cannot exceed original own funds and the lower quality additional own funds, the supplementary additional own funds, cannot exceed 50% of original own funds.

153. Items recognised as core additional own funds under Article 57(d) of the CRD fall in four categories which are:

- (d) revaluation reserves, within the meaning of Article 33 of Directive 78/660/EEC;
- (e) value adjustments within the meaning of Article 37(2) of Directive 86/635/EEC ;
- (f) other items within the meaning of Article 63(1); and
- instruments which fulfill all the conditions set out in Article 63(2):
    - securities of indeterminate duration;
    - undated cumulative preferential shares (other than those referred to in Article 57(h); and
    - other instruments.

154. The new provision in Article 63(3) allows inclusion in core additional own funds of a positive difference between value adjustments and provisions and expected loss for institutions using the IRB approach. In case of a negative difference, the negative difference will be deducted half from original own funds and half from additional own funds in accordance with Article 57(q). As this new provision is not yet in force, the report reflects the intention of the member states on the use of this item.

155. Items recognised as supplementary additional own funds under Article 57(g) to (h) of the CRD include:

- (g) commitments within the meaning of Article 64 of the CRD; and
- (h) fixed-term cumulative preferential shares and subordinated loan capital.

156. The detailed analysis of implementation by member states is set out below and provided in Annex 9.

Section 2.1. Core additional own funds

1. Revaluation reserves referred to in Article 57(d)

157. The CRD specifies the features of the revaluation reserves by reference to Article 33 of Directive 78/660/EEC. This article refers to the revaluation reserve relating to tangible fixed assets and financial fixed assets.

158. Most member states accept revaluation reserves within the meaning of Article 33 of Directive 78/660/EEC as eligible additional own funds, i.e. revaluation reserves result from the revaluation of tangible fixed assets and financial fixed assets. In Portugal and Greece, only revaluation reserves relating to tangible assets are included.

159. Only a few member states currently do not include these revaluation reserves in additional own funds (Czech Republic, Slovakia and Norway). Germany did not transpose Article 33 of Directive 78/660/EEC into German Accounting rules, therefore a very similar treatment for unrealised reserves is used but they are classified under "other items" of core additional own funds. In Luxembourg, although implemented, the provision is not applied in practice as no execution act has been issued yet.

160. Such reserves are included provided that the assets are considered by supervisory authorities to be prudently valued, i.e. fully reflecting the possibility of price fluctuation and forced sale. Some member states specify additional requirements for permissible revaluation, for instance setting requirements for the revaluation assessment process. In some member states revaluation reserves are subject to approval.

2. Positive fair value revaluation reserves for institutions applying IAS/IFRS rules

161. Most of the member states[28] and Norway where IAS/IFRS has been or will be introduced include positive fair value revaluation reserves for institutions applying IAS/IFRS rules in revaluation reserves.

162. As mentioned in paragraph 61 above, CEBS recommends that:

---

[28] Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Portugal, Slovenia, Sweden, United Kingdom

- With regard to fair value revaluation reserves on equities available for sale, unrealised gains should only partially be included in additional own funds before tax. Partially means that at least the tax effect should be taken into account;

- With regard to the fair value revaluation reserves on loans and receivables available for sale, the unrealised gains and losses, apart from those related to impairment, are neutralised (i.e. excluded from) in own funds for the amount after tax;

- For other assets available for sale (e.g. debt securities), one of the two treatments (either for loans or for equities) should be applied.

163. In the same vein, with regard to positive revaluation reserves arising from fair valuing property plant and equipment, CEBS recommends:

- cumulative unrealised gains should only partially be included in additional own funds before tax. This means that at least the tax effect should be taken into account; additionally,

- national competent authorities are encouraged to consider the need for transferring unrealised gains, if any, resulting from the initial application of the cost method to properties from original own funds to additional own funds.

164. Member states intend to apply or have applied CEBS recommendations in relation to Article 61 of the CRD which permits to fix lower ceilings for eligible own funds than those of the CRD and requires competent authorities also to take into account the foreseeable tax charges, or make suitable adjustments, so that the whole amount of revaluation reserves could be applied to cover risks or losses.

165. The structure of fair value revaluation reserves under IAS/IFRS varies to some extent among member states[29] (see table in Annex 9):

- positive fair value revaluation reserves are taken into account by a large number of member states if they are related to property used by the institution, investment property or an 'available for sale' equities portfolio;

- member states approaches are spread almost equally for positive fair value revaluation reserves for 'available for sale' debt instruments; while some member states accept this item as a part of core additional own funds, others neutralize both positive and negative fair value revaluation reserves; and

[29] member states which include unrealized gains in additional own funds, deduct unrealized losses from core original own funds. Member states which neutralize unrealised gains (generally on debt instruments and loans and receivables), also neutralize unrealised losses in core original own funds. For more information, see Chapter 1 relating to core original own funds.

- A very limited number of member states (Finland, Lithuania and Malta) include positive fair value revaluation reserves on 'available for sale' loans and receivables. For Finland and Lithuania, this item is not relevant in practice.

166. There is a certain disparity among member states on the amount of fair value revaluation included in core additional own funds. Whereas some include these reserves after deduction of taxes, others include them before taxes with a haircut[30]. Furthermore, other discounts (adjustments) related to revaluation reserves might be applied by member states, for prudential or other reasons.

167. Only a few member states[31] and Norway explained how they calculate fair value revaluation reserves, i.e. line by line or on a portfolio basis. It seems that the general practice is to apply a line by line approach for investment properties and property, plant and equipment and a portfolio approach for equities and debt securities[32]. Nevertheless, differences in methods of calculation, although technical, are important.

3. The value adjustments referred to in Article 57(e)

168. According to Article 57(e), member states may include in additional own funds value adjustments within the meaning of Article 37(2) of Directive 86/635/EEC.[33] Value adjustments represent an undervaluation of certain assets which are neither held as financial fixed assets nor included in a trading book portfolio. These value adjustments are limited to 4% of the total amount of the assets.

169. A large majority of member states[34] and Norway reported that they do not use or did not implement this clause. A very limited number of member states[35] have implemented this clause; all but Hungary limit the value adjustments to 4% of the total amount of listed assets.

---

[30]This could boil down to the same outcome, for instance 74% before tax' or 100% after tax where the corporate tax percentage is 26% are equivalent.

[31]Belgium, France, Germany, Greece, Italy, Lithuania, Luxembourg, the Netherlands, Portugal, Spain, United Kingdom

[32]Portugal applies a line by line approach for equities and debt securities and France a currency by currency approach for equities. Only Italy applies a portfolio approach for revaluation reserves on tangibles assets and investment properties.

[35]According to Article 37(2) of Directive 86/635/EEC, "pending subsequent coordination, Member States may permit:
-Loans and advances to credit institutions and customers (asset items 3 and 4) and debt securities, shares and other variable-yield securities included in asset items 5 and 6 which neither held as financial fixed assets as definer in Article 35(2) nor included in a trading portfolio to be shown at a value lower than that which would result from the application of Article 39(1) of Directive 78/660/EEC, where that is required by the prudence dictated by the particular risk associated with banking. Nevertheless, the difference between the two values must not be more than 4 % of the total amount of the assets mentioned above after application of the aforementioned Article 39;
-That the lower value resulting from the application of subparagraph (a) be maintained until the credit institution decides to adjust it;
-Where a Member State exercise the option provided for subparagraph (a), neither Article 36(1) of this Directive nor Article 40(2) of Directive 78/660/EEC shall apply."

[34]Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Greece, Ireland, Italy, Latvia, Lithuania, the Netherlands, Malta, Slovakia, Slovenia, Spain, Sweden and United Kingdom

[35] Austria, Belgium, Germany, Hungary and Luxembourg

170. The introduction of IAS/IFRS will normally affect these value adjustments and provisions which must not be maintained under IAS/IFRS. They will probably be transferred to reserves in original own funds.

4. Other items referred to in Article 63(1) and in new Article 63(3)

171. Article 63(1) gives member states the option to include as eligible additional own funds 'other items' provided that the following requirements are met:

a) they are freely available to the credit institution to cover normal banking risks where revenue or capital losses have not yet been identified;

b) their existence is disclosed in internal accounting records; and

c) their amount is determined by the management of the credit institution, verified by independent auditors, made known to the competent authorities and placed under the supervision of the latter.

172. Moreover, under new Article 63(3), institutions calculating risk weighted exposure (RWE) amounts under the IRB approach may be allowed to include positive differences between value adjustments and provisions and expected loss[36] in the core additional own funds within "other item" up to a maximum of 0.6% of RWE. A limit lower than 0.6% may be applied. For institutions that will exercise this discretion, value adjustments and provisions under Article 57(e) shall not be included within items of core additional own funds.

173. Under Article 57(q), institutions using the IRB approach must deduct the negative difference between value adjustments and provisions and expected loss from own funds. In accordance with Article 66, the negative amount is deducted half from core original own funds and half from additional own funds.

174. Nine member states (Belgium Denmark, Finland, Greece, Italy, Latvia, Slovakia, Slovenia and Sweden) reported that they are not using Article 63(1).

175. In the other member states, 'other items' generally include general provisions which however were limited to 1.25% of their risk weighted assets (e.g. Ireland, Portugal, Spain, United Kingdom and Cyprus), mutualised guarantee funds under certain conditions (France), and funds for social projects of savings banks and credit cooperative banks which are of a permanent nature (Spain).

176. Germany accepts unrealised reserves on real estate, land rights and securities subject to a haircut of 55% (for tax and volatility) up to 1.4% of RWA and only if original own funds amount at least 4.4 % of RWA.

---

[36] institutions using the IRB approach shall compare the total expected loss amounts under the IRB approach (excluding the securitisation position with a risk weight of 1250% from the RWE) and the total value adjustments and provisions calculated under valid accounting rules (local GAAP or IFRS).

177. With regard to the inclusion in core additional own funds of the positive difference between value adjustments and provisions and expected loss for institutions using the IRB approach under Article 63(3), most member states[37] have the intention of fully implementing this provision in the new legislation and none has expressed the intention of applying a lower limit than 0.6% of RWE. The other member states[38] and Norway have not decided yet about their implementation of this provision.

178. With the introduction of IAS/IFRS, the question was raised whether the "collective impairment" resulting from IAS/IFRS may be eligible for additional own funds under Article 63(1) or may be taken into account for Article 63(3).

179. Regarding Article 63(1), the United Kingdom mentioned that "collective impairments" may be included in additional own funds up to 1.25% of RWA under the current Directive and, in the future, for the institutions applying the standardized approach. In Norway, this will not be the case.

180. In member states[39] which have already decided to implement Article 63(3), it is generally expected that IRB institutions will be authorised to include "collective impairments" among the "provisions/value adjustments" that they compare to EL under Article 63(3).[40] Therefore only the result of the calculation of Article 63(3) can be included. Nevertheless, not all the member states have yet decided definitively to include collective impairments when making that comparison.

5. Securities of indeterminate duration, undated cumulative preferential shares and other instruments that fulfil a set of five conditions may be included in regulatory additional own funds in accordance with Article 63(2)

181. All but two member states (Lithuania and Slovakia) allow securities of indeterminate duration to be included in core additional own funds. The Czech Republic considers that instruments which are treated as "other equity" under international accounting rules fulfill the conditions set out in Article 63(2).

182. A large majority of member states do not include instruments with a fixed maturity in core additional own funds, with the exception of five member states: Italy (min 10 years), Austria (min 8 years), Denmark (4 years), Germany (min 5 year) and Luxembourg (min 5 years). In Italy and Luxembourg any redemption must be authorised by the competent authority. In Denmark there is a gradual amortisation of the amount of the subordinated loan capital three years before the redemption date. In

[37]Austria, Belgium, Czech Republic, Estonia, Finland, France, Greece, Germany, Ireland, Italy, Malta, Poland, Portugal, Slovakia, Spain and United Kingdom
[38]Cyprus Denmark, Hungary, Latvia, Lithuania, Luxembourg, Netherlands, Slovenia and Sweden
[39] Including United Kingdom
[40]Belgium, Italy, Finland, Germany, Portugal and United Kingdom have specified that collective impairements will be included.

Germany[41] and in Austria, there is no recognition, respectively, in the last two and three years before repayment.

183. Regarding cumulative perpetual preference shares within the meaning of Article 63(2), only a limited number of member states (Czech Republic, Denmark, Estonia and, Slovakia) and Norway do not include them in core additional own funds. Estonia plans to do so in 2007.

184. The five conditions set out by the CRD are:

- the above mentioned instruments may not be reimbursed on the bearer's initiative or without prior agreement of the supervisory authority;
- the debt agreement must provide for the credit institution to have the option of deferring the payment of interest on the debt;
- the lender's claim on the credit institution must be wholly subordinated to those of all non-subordinated creditors;
- the documents governing the issue of the securities must provide for debt and unpaid interest to be such as to absorb losses, whilst leaving the credit institution in a position to continue trading ; and
- only fully paid up amounts shall be taken into account.

185. A majority of member states[42] and Norway require institutions to obtain prior supervisory approval in order to verify compliance with the CRD requirements. Others require prior information (Slovenia) or auditor approval (Germany). The United Kingdom and Ireland require the institution to obtain an independent legal opinion stating that all the requirements have been met.

a. Safeguards have been put in place to verify that the requirement that these instruments may not be repaid on the bearer's initiative or without prior agreement of the supervisory authority, is fulfilled

186. The first condition set out in the CRD aims at preserving the permanence of the funds. Certain provisions such as call options (at the initiative of the issuer) associated with step up, or put options may undermine this criterion of permanence. Therefore supervisory authorities have developed a wide range of safeguards against the misuse of these provisions.

187. All member states, with the exception of Italy[43], authorise call options at the initiative of the issuer. However, these call options are surrounded by safeguards which are commonly used across Europe. The most commonly used practices are:

[41] these participation rights rank pari passu with common shareholders in the event of any losses even after derecognition.
[42] E.g. Belgium, Finland, France, Greece, Hungary, Italy, Luxembourg, Poland, Portugal
[43] In Italy, instruments are dated so there is no call.

- prior approval by the supervisory authority before the call can be exercised is the common practice in most member states and in Norway[44]. Only Austria, Cyprus and Slovakia do not subject the exercise of the call option to prior supervisory approval;

- a minimum period of five years before the first call date is required by Belgium, France, Greece, Slovenia, Spain, United Kingdom and Norway. The minimum period is ten years for Greece and Netherlands before the first call option or before the first call with step up (which cannot occur before ten years in Spain). In Austria, where core additional own funds can be dated, redemption is only permissible when the residual maturity of the instrument is less than two years;

- member states are cautious that too high a level of step up may put undue pressure on the issuer to redeem the instruments and jeopardize its financial soundness. This is all the more relevant in periods of stress.

- Most member states have not fixed the acceptable level formally. Nevertheless, member states reported that steps up can range from 50 bp to 150 bp. For those which have set a level for the step up that cannot be exceeded, instruments with step-up which is higher than the regulatory one are not included in supplementary additional own funds and the date of the call with step up is considered to be the maturity of the instrument. In Hungary, step-ups are not allowed at all, except for the change of variable rates.

188. Other safeguards with regard to early redemption include:

- contractual provisions may allow for early redemption at the initiative of the issuer, namely in case of changes in the tax status of the instrument. In Austria, Germany, Greece, Belgium, Italy and Luxembourg these cases are subject to the prior supervisory approval;

- the acquisition of the instruments by the issuing institution is authorized in a limited number of member states, and with caps: the Danish FSA shall approve any acquisition of own subordinated loan capital of more than 2%. Germany authorises the acquisition of instruments up to 3%. Belgium authorises the acquisition of subordinated debt instruments issued on the retail market up to 1 %;

- although Denmark, Finland, Germany, Luxembourg, Netherlands and Poland do not exclude the possibility of having a put option (at the initiative of the bearer), the exercise of the put option must be approved by the supervisory authority. In practice, in Finland the authority does not allow the instrument to be included in own funds if it contains a put option.

---

[44] Belgium, Finland, France, Germany, Greece, Ireland, Luxembourg, Poland, Portugal, United Kingdom, Slovenia, Netherlands, Spain

b. In all member states, the debt agreement must provide that the credit institution has the option of deferring the payment of interest on the debt

189. In all member states, the possibility of deferring the payment of interest, which is one of the feature that allows the issuer to have flexibility in honouring its payments and keep the funds to absorb losses, is a prior condition for including the instruments in core additional own funds.

190. Most member states require that the issuer is given the possibility of deferring payment at any time. However, in several member states (Italy, Belgium, Denmark, Estonia, Greece, Germany, Hungary, Slovenia and Spain), it is accepted that deferral is only authorised under certain conditions, or is mandatory upon the occurrence of certain deferral triggers, notably if the institution has made a loss (Germany, Slovenia, Spain and Greece), or has no more distributable profit (Belgium and Italy), or has not distributed dividends (Italy and Slovenia), or does not meet the minimum solvency ratio (Denmark and Estonia).

191. In Portugal, payment of deferred interest is subject to prior regulatory approval. In the United Kingdom only the ability to defer interest payments in cash is required.

192. The deferred coupons are always cumulative.

c. All Member States require that the lender's claim on the institution is subordinated to all non subordinated creditors

d. The documents governing the issue of the securities must provide for debt and unpaid interest to be such as to absorb losses, whilst leaving the credit institution in a position to continue trading

193. The majority of member states and Norway require this condition to be fulfilled. Only Estonia does not specify in its regulations the obligation to absorb losses as a going concern. A few member states (Italy, Austria, Belgium, Germany and Spain) reported that they have defined specific provisions regarding loss absorption. These provisions generally require conversion into another original own funds instrument (Belgium) or a write down of the debt upon occurrence of certain triggers (Belgium, Italy, Austria and Germany). These triggers may be, for instance, the occurrence of losses (Spain, Germany and Austria), losses that reduce capital below 6.3 MEUR (Italy), or insolvency (Belgium). By being able to defer payment of interest (and capital), institutions can also use their core additional own funds to absorb losses on an on-going basis.

e. All Member States only take into account fully paid up amounts in core additional own funds

194. Two member states (United Kingdom and Belgium) mentioned that the amount included must be net of any foreseeable tax charge.

6. The part of hybrid instruments recognised as supplementary original own funds which exceeds the limits imposed by supervisors is taken into account in core additional own funds

195. Hybrid instruments are not explicitly recognised in the CRD which consequently remains silent with regard to the treatment of hybrid instruments exceeding the limits imposed for inclusion in supplementary original own funds. Nevertheless, it is common practice[45] that when recognising hybrid instruments as supplementary original own funds and up to a certain limit, competent authorities[46] allow the amount exceeding the limit to be considered as core additional own funds. When competent authorities allow such treatment, all the quantitative restrictions/limits on the use of certain items and tiers of own funds remain in operation.

Section 2.2. Supplementary additional own funds

196. The CRD lists three types of capital raising instruments which can qualify as supplementary additional own funds, provided that a set of conditions laid down in the CRD is met:

- fixed-term cumulative preferential shares;
- dated subordinated loan capital; and
- undrawn commitments of the members of credit co-operatives.

197. The responses to the stock take indicate that the first two items have been recognised in all member states apart from fixed-term cumulative preferential shares which seven member states[47] and Norway reported that they did not recognise as eligible supplementary additional own funds. Austria and Czech Republic have indicated that they consider subordinated deposits as eligible additional own funds. In France capitalised interest on subordinated debt is eligible provided that it has the same degree of subordination as the principal of the debt and that the residual period of capitalisation is at least five years. Only a limited number of member states take into account the undrawn commitments of the members of cooperatives

198. Supplementary additional own funds are the lowest form of eligible regulatory own funds compared to instruments defined by Article 63(2):

- they do not necessarily cover losses on a going concern basis;
- they are not permanent: they may have a fixed maturity; and

---

[45] Hungary has reported that an excess amount of hybrids is not allowed within additional own funds
[46] Austria, Belgium, Cyprus, Denmark, Finalnd, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, the Netherlands, Norway, Portugal, Slovenia, Spain, Sweden, United Kingdom and Norway have reported such a practice- See Annex 9
[47] Denmark, Germany, Lithuania, Poland, Slovakia, Sweden and United Kingdom.

- they do not give full discretion to the issuer as to the flexibility of payments: they are cumulative.

199. The CRD sets out five conditions that the dated subordinated capital instruments mentioned above shall fulfil in order to be considered eligible for regulatory own funds. Due to their lower quality, the CRD sets lower limits under Article 66 for the capital instruments listed above.

1. Fixed-term cumulative preferential shares and subordinated loan capital as referred to in Article 57(h) are subject to five conditions of eligibility

200. Article 64(3) lists the five conditions the instruments listed in Article 57(h) must fulfil:

- a binding agreement on subordination shall exist. Subordination is determined by setting a requirement that in the event of the bankruptcy or liquidation of the credit institution, the instruments listed in Article 57(h) rank after the claims of all other creditors and are not to be repaid until all other debts outstanding at the time have been settled;

- only fully paid-up funds may be taken into account;

- the loans involved must have an original maturity of at least five years, after which they may be repaid;

- the extent to which they may rank as own funds must be gradually reduced during at least the last five years before the repayment date; and

- the loan agreement must not include any clause providing that in specified circumstances, other than the winding-up of the credit institution, the debt will become repayable before the agreed repayment date.

201. A few member states[48] and Norway[49] have reported that prior supervisory authorisation is required to include subordinated loans or cumulative preference shares as eligible additional own funds.

202. Furthermore, eligible subordinated loan capital instruments can either have a fixed maturity of at least five years or they may be initially undated but their early repayment is subject to five years' notice, unless the loans are no longer considered as own funds or unless the prior consent of the competent authorities is specifically required for early repayment. In the latter case, the competent authority may grant permission for early payment

---

[48]Belgium, Cyprus, Czech Republic, Greece (only checking of terms), Italy, Lithuania, Portugal, France and Spain

[49]Norway requires that the tier 1 capital ratio is at least between 6% and 7% depending on the risk profile before subordinated loan capital may be issued.

provided the request is made at the initiative of the issuer and the solvency of the institution is not affected.

203. A large majority[50] of member states and Norway allow early redemption either with prior supervisory authorisation or with five years' notice. For instance, redemption may be allowed when the solvency of the institution is not affected or the redeemed capital is replaced with fresh capital of at least equal quality. Acceptable reasons for redemption may also be a change in taxation. Austria requires the institution's auditor to certify that redeemed own funds have been replaced with at least the same amount and quality of capital instruments.

204. Some member states apply strictly the minimum five years' maturity requirement: early redemption is not allowed before five years has elapsed since issue.

a. Although all member states apply an amortising plan to subordinated loans during the last five years before the repayment date, the manner of application (e.g. the amortisation rate and the time of amortisation) differs.

205. The majority of member states[51] and Norway apply an annual 20% reduction, thus following the recommendation of the Basel Capital Accord[52]. Estonia applies a 5% reduction every three months. Denmark applies an annual 25% reduction during the last three years. Germany reduces down to 40% in the last two years before repayment.

206. France has detailed rules on how the linear discount of 20% per year is applied to subordinated debt instruments which have a predetermined annual schedule for redemptions[53]. Capitalised interests are subject to a prudential discount of 20% per year in the last four years of the period of capitalisation.

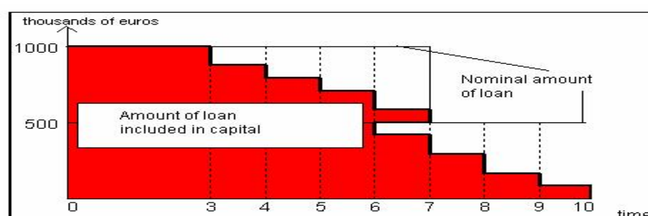
---

[50] Austria, Belgium, Czech Republic, Cyprus, Denmark, Finland, France, Greece, Germany, Hungary, Ireland, Italy, Lithuania, Luxembourg, Malta, Netherlands, Norway, Poland, Portugal, Slovenia, Spain, Sweden and the United Kingdom

[51] Austria, Belgium, Cyprus, Estonia, Finland, France, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Poland, Portugal, Slovakia, Slovenia, Spain, Sweden, United Kingdom and Norway

[52] For fixed-term subordinated loan capital and limited life redeemable preference shares the Basel Capital Accord explicitly determines that a cumulative discount (or amortisation) factor of 20% per year during the last five years to maturity will be applied to reflect the diminishing value of these instruments as a continuing source of strength. The CRD requires only that the amount of the subordinated loan capital included in own funds must be gradually reduced during the last five years without mentioning any specific discount factor.

[53] To illustrate the case, take the example of a subordinated loan of an amount of 1 MEUR with an initial maturity of 10 years and redemption of half the principal after 7 years. The amount included in capital is shown in the diagram. In this example, at the end of six years the amount of the loan included in capital is 20% of 500,000 plus 80% of 500,000 = 0,5 MEUR. In other words, the discount is 50% in the seventh year.



207. The timing of the reduction in the last year differs as well. In Finland, Hungary, Lithuania, Netherlands, Norway, Slovenia and Spain, the amount taken into account in the last year is 0%, while for Belgium, Czech Republic, France, Italy, Ireland, Greece, Luxembourg, Portugal, United Kingdom and Sweden it is 20%.

b. Additional criteria may be considered by supervisors

208. A limited number of member states[54] and Norway indicated that they only considered directly issued instruments. Belgium, Greece, Spain, Portugal and the United Kingdom indicated that they also include as eligible supplementary additional own funds instruments which are indirectly issued.

209. Several member states[55] and Norway have set limits to step-ups which vary between 50 bp and 150 bp. In France the limits on step-up are reduced in the case of term subordinated debt to 50 bp per adjustment and per period of five years, without any option of combining two five year periods. When the step-up is greater than 50 bp, the date of the step-up is considered to be the final maturity of the loan for the purposes of calculating the discount. In addition, the yield must not be more than 250 bp higher than the reference rate used. In Italy step-ups of up to 60bp are accepted, while for step ups between 60bp and 100bp the supervisory authority can decide to include in additional own funds only a portion of the nominal value. Step-ups above 100 bp are not accepted.

210. Generally, neither set-off[56] provisions nor secured and/or collateralised instruments[57] are allowed.

211. Specific requirements can be attached to the legal documentation. A legal opinion can be required e.g. in the United Kingdom and Ireland, and in Belgium when foreign law applies. It is also required in some cases that investors are informed that they are investing in a subordinated instrument (e.g. in Austria, Germany, Italy, Spain and United Kingdom), and that the clauses governing subordination, repayment and the liquidation of the credit institution are construed in accordance with the law of the member state (e.g. in Luxembourg).

2. A very limited number of member states[58] allow inclusion of the commitments of the members of institutions set up as credit cooperatives, referred to in Article 57(g)

212. It seems that this item, and consequently the technicalities surrounding its recognition as eligible own funds (e.g. limits, exceptions, due dates) are

---

[54]Cyprus, Finland, Hungary, Italy, Lithuania, Malta and Slovenia,

[55]Czech Republic, Denmark, Greece, Finland, France, Ireland, Italy, Slovenia, United Kingdom and Norway

[56]Austria, Belgium, Czech Republic, Cyprus, Finland, Germany, Hungary, Netherlands, Spain, United Kingdom and Norway

[57]Austria, Belgium, Czech Republic, Cyprus, Finland, Germany, Italy (no guarantee), Poland, Spain, Sweden, United Kingdom and Norway

[58]Austria, Cyprus, Germany, the Netherlands and Poland

very much driven by the existence and the legal form of the status of 'cooperative societies', which differ across Europe.

Section 2.3. Additional own funds cannot exceed original own funds and supplementary additional own funds cannot exceed 50% of original own funds

213. Article 66 states that additional own funds shall be subject to the following limits:

(a) the total of the items in points (d) to (h) may not exceed a maximum of 100% of the items in points (a) plus (b) and (c) minus (i) to (k); and

(b) the total of the items in points (g) to (h) may not exceed a maximum of 50% of the items in points (a) plus (b) and (c) minus (i) to (k).

214. All member states[59] have indicated that they apply the limits laid down in Article 66(1)(a).

215. All member states, apart from Denmark, have indicated that they apply the limits set out in Article 66(1)(b). However, the Czech Republic has indicated that only subordinated loan capital (Item h) is subject to the 50% limit (but fixed-term cumulative preferential shares are not acceptable for additional own funds). In Hungary only subordinated loan capital is limited to 50% of original own funds. Estonia has decided only to sum subordinated debt and fixed-term cumulative preference shares and subject them to the 50% limit.

216. Under Article 66(3), competent authorities may authorise credit institutions to exceed the limits mentioned above in temporary and exceptional circumstances.

217. Few member states (e.g. Italy, Greece, Germany, Malta[60], France, Portugal, Spain and Luxembourg) have indicated that they have implemented or exercised this provision, generally for a short period of time to allow institutions to regularise their positions. Thirteen member states[61] and Norway have advised that they have not applied this provision. Estonia intends to implement it.

---

[59] In Hungary the limit is defined in more general terms i.e. the amount of additional own funds shall not exceed the amount of original own funds

[60] Malta has implemented but not exercised this provision yet.

[61] Belgium, Finland, Denmark, United Kingdom, Czech Republic, Lithuania, Slovenia, the Netherlands, Sweden, Latvia, Ireland, Hungary and Cyprus

CHAPTER 3: The CALCULATION OF TOTAL OWN FUNDS

218. In addition to the deductions mentioned in paragraphs 70 to 81, the CRD[62] lists the items that shall be deducted when calculating the total of regulatory own funds.

219. The CRD also permits member states to deduct items that are not listed in the CRD, in accordance with Article 61. Some have exercised this discretion.

Section 3.1. The CRD requires a set of items to be deducted half from original own funds and half from additional own funds

220. Article 66(2) and (2)(a) introduce a new way of deducting participations, the negative amount resulting from the calculation of expected loss and unrated securitisation amounts[63].They shall be deducted half from the total of original own funds, and half from the total of the items additional own funds, after application of the limits mentioned in paragraph 212. All member states have reported to have or are in a process to implement this requirement.

221. To the extent that half of their total exceeds the total of additional own funds, the excess shall be deducted from the total of original own funds. Items in (r) shall not be deducted if they have been included in the calculation of risk-weighted exposure amounts as specified in Annex IX, Part 4, paragraph 2.

222. The following items shall be deducted in accordance with Article 66:

- (l) holdings in other credit and financial institutions amounting to more than 10 % of their capital;
- (m) subordinated claims and instruments, referred to in Articles 63 and 64(3), which a credit institution holds in respect of credit and financial institutions in which it has holdings exceeding 10 % of the capital in each case;
- (n) holdings in other credit and financial institutions of up to 10 % of their capital, subordinated claims and other instruments referred to in Articles 63 and 64(3) which a credit institution holds in respect of credit and financial institutions other than those referred to above in respect of the amount of the total of such holdings, subordinated claims and instruments which exceed 10 % of that credit institution's own funds calculated before the deduction of items (l) to (p) of Article 57;
- (o) participations within the meaning of Article 4(10) which a credit institution holds in:

[62] For reporting purposes, CEBS has developed COREP templates that show the list of items and the way they are calculated. http://www.c-ebs.org/documents/GL04_CA.xls
[63] items l to r of Article 57

(i) insurance undertakings (within the meaning of Article 6 of Directive 73/239/EEC, Article 4 of Directive 2002/83/EC or Article 1(b) of Directive 98/78/EC);
(ii) reinsurance undertakings (within the meaning of Article 1(c) of Directive 98/78/EC); and
(iii) insurance holding companies within the meaning of Article 1(i) of Directive 98/78/EC;

- (p) each of the following items which the credit institution holds in respect of the entities referred to above in which it holds a participation:

  (i) instruments referred to in Article 16(3) of Directive 73/239/EEC; and
  (ii) instruments referred to in Article 27(3) of Directive 2002/83/EC;

- (q) for credit institutions calculating risk-weighted exposure amounts under the IRB approaches, negative amounts resulting from the calculation in Annex VII, Part 1, para 34 and expected loss amounts calculated in accordance with Annex VII, Part 1 para 30 and 31; and

- (r) the exposure amount of securitisation positions which receive a risk weight of 1250% under Annex IX, Part 4, calculated in the manner specified there.

1. The approach to deduction of the holdings listed in Article 57 (l) to (n), (q) and (r) is generally similar across Europe

223. Article 57(l) and Article 57(m) are commonly applied across Europe. Sweden and Norway apply a lower threshold to these provisions, respectively 5% and 2%.

224. With regard to Article 57(n), dealing with deductions of non qualifying participations and subordinated claims in the undertaking in which a participation is held, two different approaches have been reported:

1. most member states sum all the participations below the qualifying threshold (generally 10%, but 2% for Norway and 5% for Sweden), add subordinated claims on the same undertaking and deduct the portion that exceeds 10% of the regulatory capital of the institution;

2. United Kingdom considers that the total holding (*e.g.* share capital and subordinated debt) in an individual institution should be deducted where these are higher than 10% of the holder’s capital, independently of whether that the individual holding is or is not below the qualifying threshold.

225. The Recast Directive 93/6/EEC, Annex VII, Part CA, paragraph 3, states that “competent authorities may allow institutions to treat positions that are holdings as set out in Directive 2000/12/EC Article 57(l), (m) and (n) in the trading book as equity or debt instruments as appropriate where an

institution demonstrates that it is an active market maker in these positions. In this case, the institution shall have adequate systems and controls surrounding the trading of eligible own funds instruments”. Three member states (Germany, Italy and Sweden) have declared their intention to implement this provision. Five member states (Malta, Spain, Finland, Lithuania and United Kingdom) and Norway have expressed their intention not to use this discretion while four member states (Hungary, Portugal, Slovenia and Luxembourg) have not yet decided.

226. Most member states have implemented or intend to implement Articles 57(q) and (r). Annex 10 provides further details of implementation.

2. Member states have implemented or intend to implement Articles 57(o) and (p) in rather different ways

227. Different approaches seem to be envisaged, especially for the deduction of holdings in insurance undertakings:

. The deduction of participation. Different approaches of implementation have been identified:

i) the deduction of more than 20% of insurance share and other participation lower than 20%, if they have a close link with the insurance[64],

ii) the deduction of only participation exceeding the 20% share,

iii) the deduction of holdings in insurance companies in the same way as holdings in other financial institutions (i.e. with the 10% threshold laid down in Article 57(l) to (n)). This is the case for instance in Czech Republic, Finland, Hungary, Ireland in part, Lithuania and Slovenia and Norway.

. The deduction of insurance capital requirement.

228. Other member states are still in the process of implementing Article 57(o) and (p).

229. More details on the technicalities of the deductions are provided in Annex 10.

230. Article 154(1)(b) allows member states to apply to participations in insurance undertakings acquired before 31 December 2006 the deduction rule provided by the text of Directive 2000/12/EC (deduction from the sum of original own funds and additional own funds) instead of the deduction rule provided by Article 66(2) (deduction of 50% from original own funds and 50% from additional own funds), until 31 December 2012.

[64]Participations which exceed 20% of the share capital of the institutions in which they are held, or number of voting shares, and all other participations which constitute a close link or a long term link

231. The way this provision will be applied is likely to differ in Europe. Belgium, Finland, France, Italy, Sweden and United Kingdom have declared their intention to use this discretion. By contrast, Germany, Malta, Spain, Hungary, Lithuania and the Netherlands do not intend use it. The others (e.g. Denmark, Greece, Luxembourg, Portugal, Slovenia and Norway) have not decided yet.

3. The calculation of regulatory own funds for the purpose of Large exposures and qualifying holdings outside the financial sector

232. For the purposes of Sections 5 (large exposures) and 6 (qualifying holdings outside the financial sector), it shall be noted that regulatory own funds shall be read without taking into account the items referred to in (q) and (r) of Article 57 and Article 63(3)(2a).

233. Moreover, in application of Article 106(1), third paragraph with regard to large exposures and of Article 122(2) with regard to the qualifying holdings, several member states (e.g. Germany, Portugal, Hungary, United Kingdom) have reported that their national rules require the deduction from the total own funds of the excesses on limits of large exposures[65] and qualifying holdings.

4. Member states have indicated their intended choices of implementation of the new national discretions laid down in Articles 58, 59 and 60 of the CRD

234. The stock take indicates that member states use a wide range of approaches to the application of these three national discretions.

235. A vast majority of member states[66] have implemented or intend to implement Article 58 which allows competent authorities not to deduct participations in items (l) to (p) of Article 57 where these participations are held temporarily for the purposes of a financial assistance operation designed to reorganise and save the entity.

236. Several member states[67] have not implemented or do not intend to implement the discretion provided by Article 59 which allows member states to permit their credit institutions to apply the method laid down in Annex 1 of the Financial conglomerates directive, as an alternative to the deduction of items (o) to (p) (insurance undertakings) of Article 57.

237. Several member states[68] have not implemented or do not intend to implement the discretion provided by Article 60 which allows member states to provide that for the solo calculation of own funds, credit institutions subject to supervision on a consolidated basis or to supplementary supervision, need

[65] For further details, CEBS carried out a stock take on this provision in the context of the survey of the national implementation of large exposures rules. The results have been summarized and published on the CEBS website in http://www.c-ebs.org/Advice/advice.htm
[66] Apart from Austria, Czech Republic, Hungary, Portugal, Slovakia, Sweden and Norway
[67] Czech Republic, Denmark, Spain, Finland, Hungary, Lithuania, Poland, Sweden, Slovenia,
[68] Cyprus, Hungary, Malta, the Netherlands, Poland, Portugal, Slovenia, Sweden, United Kingdom

not deduct items (l) to (p) of Article 57 which are held in entities included in the scope of consolidated or supplementary supervision.

Section 3.2. Some member states have indicated that they deduct from regulatory own funds items that are not listed in the CRD

238. Article 61 allows member states to deduct items other than those listed in the CRD. Several member states (Germany, Greece, Spain, France, Hungary, Italy, Portugal, Slovenia and United Kingdom) have used that discretion and reported the relevant deductions listed in Annex 10.

.

CHAPTER 4: ANCILLARY OWN FUNDS

Section 4.1. Ancillary own funds share the same key common basic features

239. The Basel Capital Accord introduced the concept of "Tier 3" capital in 1996, when criteria were issued for the application of capital charges to market risks[69] and which referred to short-term subordinated debts eligible for the sole purpose of meeting a proportion of the capital requirements for market risks.

240. In the EU, the definition of "Tier 3" (hereinafter referred to as ancillary own funds) is addressed in the recast Directive 93/6/EEC.

241. The own funds of credit institutions and investment firms shall be determined in accordance with the rules laid down for the computation of original and additional own funds. However, according to the recast Directive 93/6/EEC, and in derogation from the principle mentioned in the previous sentence, competent authorities may permit institutions to use an alternative determination of own funds specifically to meet the capital requirements in respect of their trading book (including large exposures in the trading book), foreign exchange risk and commodities risk. Consequently, no part of the own funds used for that purpose may be used simultaneously to meet other capital requirements.

242. This alternative determination of own funds consists of the sum of the following items (Article 13(2),2nd paragraph, a) to c)):

- own funds as defined in the recast Directive 2000/12/EC, excluding only points (l) to (p) of Article 57 of that Directive for those investment firms which are required to deduct illiquid assets from this alternative determination of own funds;
- net trading-book profits net of any foreseeable charges or dividends, less net losses on its other businesses provided that none of those amounts has already been included in original and additional own funds; and
- subordinated loan capital and/or the items referred to in article 13(5) of the recast Directive 93/6/EEC;
- less, at the discretion of the competent authorities, illiquid assets.

[69]Basel Committee on Banking Supervision, *Amendment to the Capital Accord to Incorporate Market Risks* (January 1996).

243. The trading book mentioned above refers to the regulatory definition of the trading book, which should not be affected by the introduction of IAS/IFRS.

244. The implementation of the recast Directive 93/6/EEC concerning ancillary own funds is not entirely consistent across member states.

245. Most member states have implemented the alternative determination of own funds or have allowed the inclusion of specific items to meet the capital requirements referred to above. For the latter, the specific item is, mainly, short-term subordinated loan capital. Three member states and Norway have not implemented the alternative definition of own funds (Denmark, Greece and Spain for credit institutions).

246. In general[70], the same rules apply to credit institutions and investment firms.

247. Without prejudice of the main conclusions of the preceding paragraphs, it would be fair to say that institutions tend to cover the capital requirements in respect of their market risks primarily through original and additional own funds rather than making wide use of the specific items comprising ancillary own funds.

Section 4.2. Ancillary own funds are mainly composed of net trading book profits and subordinated loan capital, from which illiquid assets are deducted

1. Net trading book profits

248. Article 13(2) 2nd paragraph, (b) states that an institution's net trading-book profits, net of any foreseeable charges or dividends, less net losses on its other businesses, and provided that none of those amounts has already been included in original or additional own funds, may be included in the alternative definition of own funds. Annex 10 sets out in detail how member states have used it.

2. Subordinated loan capital

a. Subordinated loan capital shall meet five criteria to be eligible as ancillary own funds

249. The five requirements laid down in Article 13(3) 1st and 2nd paragraphs are:

- it shall have an initial maturity of at least two years;
- it shall be fully paid up;

[70] Belgium, Germany , France , Finland , Hungary, Italy, Luxembourg, Malta, Netherlands, Portugal, Slovakia, Slovenia and United Kingdom

- the loan agreement shall not include any clause providing that in specified circumstances, other than the winding up of the institution, the debt will become repayable before the agreed repayment date, unless the competent authorities approve the repayment;
- neither the principal nor interest may be repaid if such repayment would mean that the own funds of the institution would then amount to less than 100% of that institution's overall requirements; and
- the competent authorities shall be notified of all repayments on such subordinated loan capital as soon as an institution's own funds fall below 120 % of its overall capital requirements.

250. Member states which allow the use of ancillary own funds have generally implemented these criteria. More specifically however, it should be noted that two member states (Latvia and Slovakia) require a minimum maturity of 3 years. Furthermore, the notification of all repayments as soon as own funds fall bellow 120% of overall capital requirements has not been implemented by seven member states (Austria, Czech Republic, Ireland, Italy, Lithuania, Malta and Slovakia).

251. In addition to the set of requirements mentioned above, competent authorities have put in place supervisory practices and requirements which are generally similar to, or consistent with, those applied for the other capital instruments. The main practices are:

- prior approval by the supervisory authorities is often required e.g. in Belgium, Czech Republic, France, Italy, Lithuania and Portugal but not in Malta, Sweden and United Kingdom;
- the possibility of early repayment, at the initiative of the issuer, subject to certain conditions, e.g. with advanced notice of at least the required minimum initial maturity, or after the initial maturity without a period of notice, or because of a change in taxation rules, or provided the issuer has procured capital of the same amount and at least of the same quality;
- specific rules exist regarding purchases of securitised subordinated liabilities issued by the purchaser (e.g. for market-smoothing purposes); and
- few member states e.g. Austria, Czech Republic, Germany, Finland, Hungary and United Kingdom do not allow offsetting.

252. Article 13(5) of the recast Directive 93/6/EEC establishes that competent authorities may permit institutions to replace subordinated loan capital eligible for ancillary own funds with additional own funds (items (d) to (h) of Article 57 of the recast Directive 2000/12/EC).

253. This provision has not been implemented in several countries (Cyprus, Czech Republic, Finland, Latvia, Malta, Poland, Slovakia, Slovenia and Sweden). The other member states which allow the use of ancillary own

funds, have implemented this article whether explicitly or implicitly[71]. The Netherlands permits the replacement referred to above only with prior approval of the competent authority.

b. Subordinated loan capital is subject to limits

254. Article 13(4) of the recast Directive 93/06/EEC imposes certain limits on the eligibility of this item, establishing that subordinated loan capital may not exceed a maximum of 150% of original own funds left to meet the requirements in respect of an institution's trading book and may approach that maximum only in particular circumstances acceptable to the competent authorities.

255. The 150% limit has been implemented in the following member states: Cyprus, Czech Republic[72], Estonia, Italy, Poland, Slovakia, Spain, Sweden and United Kingdom). Poland has established this limit with the addition of special local requirements.

256. Nonetheless, Article 14 of the recast Directive 93/6/EEC allows competent authorities to permit the ceiling in Article 13(4) to be exceeded if they judge it prudentially adequate, provided that:

- in case of investment firms, the total of such subordinated loan capital and the items referred to in Article 13(5) does not exceed 200% of the original own funds left to meet the requirements for market risks[73], or 250% of the same amount where investment firms deduct the item 'illiquid assets' when calculating own funds (Article 14(1)); and
- in the case of a credit institution, the total of such subordinated loan capital and points (d) to (h) of Article 57 of Directive 2000/12/EC does not exceed 250% of the original own funds left to meet the requirements for market risks (Article 14(2)).

257. The discretion in Article 14(1) has been implemented in twelve member states, although not homogeneously. Some member states apply this limit to investment firms and credit institutions (Belgium, Hungary, Latvia and Portugal). Others apply it only to investment firms (France with a lower limit - 200% - Spain and Luxembourg) or only to credit institutions (Austria, Estonia, Lithuania[74]). Germany and the United Kingdom have adopted the two options provided by the Directive. In Hungary, the limit is 200%, which refers not only to short term Tier 3 subordinated loan capital but also includes other additional own funds elements, as well.

[71]Estonia will implement it during its transposition of the CRD.
[72]This provision will be implemented during the transposition of the CRD.
[73] calculated in accordance with Articles 21, 28 to 32 and Annexes I and III to VI
[74]Bank of Lithuania does not supervise investment firms.

258. The limit set in Article 14(2) has been implemented in few member states[75]. In Italy, this limit may be applied subject to prior approval of the competent authority on a case by case basis.

3. Illiquid assets

259. The deduction of illiquid assets referred to in Article 13(2) is left to the national discretion in the Member States where the alternative determination of own funds is possible.

260. Eight member states (Germany, Netherlands- only for investment firms, Sweden, Italy, Spain –only for investment firms and Luxembourg - only for investment firms exempted from consolidated supervision, Slovenia and United Kingdom) require the deduction of illiquid assets referred to in Article 13(2)(d). Please refer to Annex 10 for the detailed treatment. The remaining member states do not allow, or do not regard as relevant for the alternative determination, the deduction of illiquid assets.

261. Article 15 of the recast Directive 93/6/EEC lists seven types of illiquid asset Furthermore, it is also stated that where shares in a credit or financial institution are held temporarily for the purpose of a financial assistance operation designed to reorganise and save that institution, the competent authorities may waive the deduction. They may also waive it in respect of those shares which are included in the investment firm's trading book. Annex 10 provides the detailed composition of 'illiquid assets' in the member states which require their credit institutions and/or investment firms to deduct them.

4. Implementation of Article 16 with regard to Investment Firms

262. Article 22 of the recast Directive 93/6/EEC allows competent authorities, required or mandated to exercise supervision of groups covered by Article 2 of that same Directive on a consolidated basis, to waive, on a case by case basis, the application of capital requirements on a consolidated basis under the circumstances there specified. According to Article 16, investment firms included in a group which has been granted that waiver, shall calculate their own funds in accordance with Articles 13 to 15 subject to the five requirements set out in the CRD.

263. Article 16 is implemented in five member states (Austria, Germany, Italy, Netherlands, and United Kingdom). Luxembourg, Portugal and Slovakia have yet to take final decisions. The remaining member states do not use these provisions.

[75] Germany, France, Ireland, Italy, Luxembourg, Slovakia, Slovenia and United Kingdom. This is the limit currently in use in Czech Republic although the ceiling in Article 13(4) will be implemented during the transposition of the CRD.

5. Implementation of Article 17 - capital requirements for settlement risk as regards 'free deliveries'

264. Article 17 of the recast Directive 93/6/EEC deals with the calculation of risk-weighted exposure amounts for determining the capital requirements for settlement and counterparty credit risk, namely the treatment of expected loss amounts when such risk-weighted exposure amounts are estimated using the Internal Ratings Based Approach. Regarding settlement risk, and in relation to trading-book business, according to Annex II of Directive 93/6/EEC institutions shall be required to hold own funds for 'free deliveries' and the CRD sets out how a 'free delivery transaction' shall be treated .

265. At this stage, most member states have not yet taken final decisions regarding the implementation of this article. Only a handful of member states have already said that they will implement the provisions (Belgium, Czech Republic, Estonia, Finland, Hungary, Latvia and Malta).

6. Other provisions relating to the trading book – standards for less liquid items

266. According to Annex VII, part B of the recast Directive 93/6/EEC, institutions shall establish and maintain adequate systems and controls to provide prudent and reliable valuation estimates for the positions held in the trading book. Those provisions include standards for 'less liquid assets' for which it may be necessary to determine a valuation reserve. When valuation adjustments/reserves are set up for 'less liquid assets[76]' and give rise to material losses in the current financial year, they shall be deducted from an institution's original own funds, under Article 57(k) of the recast Directive 2000/12/EC.

267. Other profit/losses originating from valuation adjustments/reserves shall be included in the calculation of "net trading book profits" as foreseen in Article 13(2)(b) of the recast Directive 93/6/EEC (according to which they are added to/deducted from the own funds eligible to cover market risk requirements).

268. The valuation adjustments/reserves which exceed those made under the accounting framework to which an institution is subject shall be treated in accordance with the rules in the previous paragraphs.

Conclusion

269. On the basis of the information provided by member states and Norway, CEBS' survey has been undertaken to shed some light upon the various items eligible to be regulatory own funds in Europe. It aims to identify the existing divergences and commonalities among the European own funds regimes and the criteria for permanence, loss absorption and flexibility of

---

[76]Less liquid positions' could arise from both market events and institution specific situations (e.g. concentrated positions and/or stale positions).

payments that supervisors assess capital instruments against, and the interplay between the different layers. The survey could prepare the ground on which the most commonly shared guiding principles could be devised later on As set out in the Call for Advice CEBS received from the Commission, further key steps in the own funds review will be to carry out a quantitative analysis of the types of capital held by institutions and to reflect on and elaborate a common understanding of the fundamental purposes of own funds and capital.

Annexes

- Annex 1 : Structure of current definitions of own funds- Corresponding table between terminologies
- Annex 2 : Denominations of own funds
- Annex 3, Chapter 1- Overview of original own funds across Europe (attached)
- Annex 4, Chapter 1- Capital and reserves (attached)
- Annex 5, Chapter 1-Interim profits (attached)
- Annex 6, Chapter 1-Deductions (attached)
- Annex 7, Chapter 1-Consolidation (attached)
- Annex 8, Chapter 1-Hybrid instruments (attached)
- Annex 9, Chapter 2-Additional own funds (attached)
- Annex 10, Chapter 4-Ancillary own funds (attached)

Annex 1

Table 1 - Structure of current definitions of own funds- Corresponding table between terminologies

	1988 Basel Accord and 1998 press release		*EU legislation*	
	Denominations	*Descriptions*	*Denominations*	*Descriptions*
Tier 1	Core capital (basic equity) (Upper Tier 1)	• Paid-up share capital/common stock. • Disclosed reserves.	Original Own Funds Items (a), (b) and (c) of Article 57) of the recast Directive 2000/12/EC	• Subscribed capital, in so far as it has been paid up, plus share premium accounts but excluding cumulative preferential shares. • Reserves and profits and losses brought forward as a result of the application of the final profit or loss. • Funds for general banking risks.
Tier 1	Instruments eligible for inclusion in Tier 1 capital (Lower Tier 1)	• Innovative capital instruments with step-up clauses.		
Tier 1	Deductions from Tier 1	• Goodwill	Deductions Items (i), (j) and (k) of Article 57 of the recast Directive 2000/12/EC	• own shares at book value • intangible assets within the meaning of Article 4(9) of Directive 86/635/EEC • material losses of the current financial year
Supplementary capital - Tier 2	(Upper Tier 2)	• Undisclosed reserves. • Asset revaluation reserves. • General provisions/general loan-loss reserves. • Hybrid (debt/equity) capital instruments.	Additional own funds Items (d), (e) and (f) of Article 57 of the recast Directive 2000/12/EC	• Revaluation reserves. • Value adjustments. • Other items (items meeting the requirements set forth in Art. 63 recast Dir. 2000/12; securities of indeterminate duration and other instruments meeting the requirements set forth in Art. 63.2 recast Dir. 2000/12, including perpetual cumulative preferential shares).
Supplementary capital - Tier 2	(Lower Tier 2)	• Subordinated term debt.	Items (g) and (h) of Article 57 of the recast Directive 2000/12/EC	• Commitments of the members of credit institutions set up as co-operative societies. • Fixed-term cumulative preferential shares and subordinated loan capital (items meeting the requirements set forth in Art. 64.3 recast Dir. 2000/12).
Deductions	Deductions from total	• Investments in the capital of other banks and financial institutions (at the discretion of national authorities)	Items (l) to (r) of Article 57 of Directive 2000/12/EC	• holdings in other credit and financial institutions amounting to more than 10% of their capital • holdings in financial and credit institutions of up to 10% of their capital in excess of 10% of the holders' own funds • participations in insurance and reinsurance undertakings, insurance holding companies • negative amounts arising from the calculation of EL • exposure amount of 1250%-risk weighted securitisation amounts
Tier 3		• Short-term subordinated debt.	Own funds as defined in the recast Directive 93/6/EEC	• Net trading book profits. • Subordinated loan capital. • Less: illiquid assets.

Extract: BAC-GTIAD Survey-2001- with updated references from the CRD

Annex 2

Table 2 - Denominations of own funds proposed by the BAC-GTIAD survey that the report has used for the sake of consistency

Denominations			***Descriptions***
Own funds	Original Own Funds (class 1)	Core Original Own Funds (class 1A)	• Subscribed capital, in so far as it has been paid up, plus share premium accounts but excluding cumulative preferential shares. • Reserves and profits and losses brought forward as a result of the application of the final profit or loss. • Funds for general banking risks.
		Supplementary Original Own Funds (class 1B) [MAX. x% CLASS 1]	• Capital instruments meeting certain requirements.
		Deductions from Original Own Funds	• Own shares at book value. • Intangible assets • Material losses of the current financial year.
	Additional Own Funds (class 2) [MAX. 100% CLASS 1]	Core Additional Own Funds (class 2A)	• Revaluation reserves. • Value adjustments. • Other items . • Own Funds class 1B instruments exceeding the above mentioned limit.
		Supplementary Additional Own Funds (class 2B) [MAX. 50% CLASS 1]	• Commitments of the members of credit institutions set up as co-operative societies. • Fixed-term cumulative preferential shares and subordinated loan capital
	Deductions from Own Funds		• Holdings, subordinated clims and other items in credit and financial institutions in which the holder has holdings exceeding 10 per cent of the capital in each case. • Holdings, subordinated claims and other items in credit and financial institutions of up to 10 per cent of their capital, exceeding 10 per cent of the holder's own funds calculated before the deduction of items referred to above. • participations in insurance and reinsurance undertakings, insurance holding companies • negative amounts arising from the calculation of EL • exposure amount of 1250%-risk weighted securitisation amounts
	Ancillary Own Funds (class 3)		• Net trading book profits. • Subordinated loan capital [MAX. 150% OR 250% OF CLASS 1 LEFT TO MEET THE REQUIREMENTS LAID DOWN IN ANNEXES I and III to VI, DIR. 93/6/EEC]. • Less: illiquid assets.
Upper level	***Intermediate level***	***Lower level***	

Extract: BAC-GTIAD Survey-2001- with updated references from the CRD