



EBA Consultation Paper on Draft Regulatory Technical Standards on Own Funds under Articles 33(2), 69a (6) and 79(3) of the draft Capital Requirements Regulation (CRR)-Part three (EBA/CP/2013/17)

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Summary

We gladly take the opportunity to deliver our opinion on the EBA Consultation Paper on Draft Regulatory Technical Standards on Own Funds (Part Three). We have made our detailed comments with the help of the catalogue of questions provided to us.

However, we would to mention some essential issues beforehand that require special attention in our opinion:

- Deductions for opaque positions – technique of look-through / simplification

Looking at EBA's very wide definition of "index" (along with the limits set in RTS 2013-01 (near final draft), all indirect holdings seem to be included in that definition. For these, the structured-based approach seems to be only applicable under the precondition that a look-through is too "operationally burdensome".

The consequence, which is to treat the entire intransparent position as a 100% investment in own funds, seems to be disproportionate. This is particularly the case for pension funds, based on the fact that the trustee is usually prohibited to directly invest in instruments of the institution to protect pension beneficiaries.

We would, therefore, welcome an extended approach to the application of the structured-based approach, cf. Q03.

- Deduction of synthetic holdings

Pursuant to the FAQ of the Basel Committee (question 15) in all cases, the loss that a bank would suffer on the exposures if the capital of the financial institution is permanently written-off is subject to a deduction treatment. The "notional amount" used as basis in this consultation paper for the calculation of synthetic holdings does not do justice to this basic intention of the provisions. In particular for options, the use of the notional amount is inappropriate. By using the notional amount the economic risks would be incorrectly represented since the likelihood of exercise is neglected.

In the case of transactions that have the character of an option, the delta-equivalent should be used rather, as shown e.g. in Articles 280 and 329 CRR, cf. Q05.

- Tranche calculation

We cannot comprehend the calculation by tranches as per Art. 14c (1) b) because it does not become clear why the calculation has to be done separately for the different tranches. The degree of complexity of the calculation increases without the benefit of this becoming clear. Moreover, application of the calculation formula sometimes leads to improper results, cf. Q06 and appendix.

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We have taken the liberty to also deliver our opinion on some cross-cutting subjects in the area of own funds because they are of fundamental importance and closely related to the present consultation paper. Detailed explanations on this are provided at the supplemented Q 13 (cross-cutting comments). They concern the following issues:

- Treatment of items for which a look-through is demonstrated to be impossible (RTS on own funds part I)

EBA RTS on own funds (part I) allows the institutions to deviate from the general look-through requirement under the condition that a look-through is possible. Cases in which an institution is completely unable to make a look-through are not adequately taken account of. Rather, the impossibility of a look-through is to result in the complete deduction of the item from the Common Equity Tier 1 which is not reasonable from the point of view of Deutsche Kreditwirtschaft.

For these cases, a procedure should be included based on the method presented at question 3 of this consultation paper.

Furthermore, the definition of the term "index holdings" in the above-mentioned Technical Standard is very wide. From the point of view of Deutsche Kreditwirtschaft, the EBA is exceeding its mandate at this point as the authorisation of Article 76 Para. 4 does not extend to the definition of the term "index holdings". In particular, substantial overlapping and inconsistencies with the present Standard, which addresses indirect holdings, arise from such a wide definition.

See Q 13 for the details.

- Definition of the term "financial sector entity", Art. 4 No. 27 CRR

Mixed Activity Holding Companies (MAHC) and Mixed Activity Insurance Holding Companies (MAIHC) seem to have been included in the definition of the term "financial sector entity" in Art. 4 No. 27 (i) and (j) CRR without foreseeing the effects of this alteration.

The definitions of MAHC and MAIHC also encompass parent companies which are not themselves part of the financial sector (such as automobile manufacturers or power companies) and fully assign them to the financial sector if they have even one subsidiary which is either an institution (e.g. an auto bank or an energy trader) or an insurance company — and this irrespective of the volume of such activities.

The inclusion considerably reduces the Common Equity Tier 1 in the case of institutions that hold shares in or lend money to such entities and at the same time, an increase of the risk-weighted assets of the institutions occurs. These provisions are not provided for by the Basel Committee and mean a considerable worsening of the competitive position of European Banks.

At the same time, these rules result in substantial disadvantages to the real economy entities affected.

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We very much plead in favour of deleting the Letters i) and j) from the Level 1 text (of the CRR) and call on the EBA to support this petition vis-à-vis the Level 1 rule makers. Moreover, we suggest that the EBA draw up an interpretation aid for this provision in the form of a guideline.

Finally, from the point of view of Deutsche Kreditwirtschaft, the definition of the term "financial institution" is also too wide (Art. 4 Para. 26 CRR), namely in the subform "an entity which is not an institution and whose main activity is to acquire holdings (...)".

See Q 13 for the details.

Q01: Are the provisions of Article 14a sufficiently clear? Are there issues which need to be elaborated further?

Article 14a, Para. 1:

The EBA has no mandate to extend the definition of indirect holdings of Art. 4 Para. 1 No. 114 CRR. Accordingly, "including senior exposures" and the addition "but are not limited to" should be deleted.

The definition of "intermediate entities" only excludes institutions ("other than institutions"). According to this definition an institution might have to deduct a certain investment twice. Example: An institution holds capital instruments of a financial sector entity, that has an investment in a second institution. The RTS (and the CRR) stipulates, that in this case there are two holdings: a direct holding (investment in the financial sector entity) and an indirect one (further institution). To rule out double deductions EBA should make clear that the institution has to deduct only one holding not both. Owing to the deduction of the direct holding the risk of double gearing of own funds no longer exists.

Further, according to the explanatory text on page 14 below, the exception in Art. 14a Para.1 should explicitly refer to entities that are subject by virtue of applicable national law to the requirements of the CRR and the CRD. These entities should not be considered as intermediate entities since they are already covered by the CRR provisions related to deductions from own funds. Thus, they must treat holdings in financial sector entities as direct holdings.

We take a critical look at the inclusion of securitisation SPEs into the provision of indirect holdings. There is indeed a large extent of transparency required for those positions, as well as the need to adequately consider the risks resulting therefrom. The transparency level required is however already ensured through extensive due-diligence-requirements (esp. Art 395 CRR). The risk resulting from securitisation exposure is – in addition to the risks of the securitised portfolio (incl. possible holdings) – determined by thickness and seniority of the individual tranches. The CRR allows for several partly complex methods to calculate this risk and therefore ensure the adequate consideration of the risk. In contrast we believe that the calculation for holding positions is insufficient to represent the specific risk resulting from securitisation exposures. Those risks should therefore exclusively be dealt with in the securitisation framework.

We, therefore, propose a new wording of Article 14a Para. 1 Letter a):

"Mutual funds, investment funds, pension funds, index funds or ~~securitisation~~ special purpose entities (other than securitisation SPE) that hold capital instruments of financial sector entities;"

With respect to the application of Art. 14a Para. 1 Letter c (i) Letter f, it should be clarified that any financial holding is to be deducted only once in an institutional protection scheme or a network of institutions.

Where own funds are provided to an intermediate entity which are used to acquire holdings in an institution (target entity), exclusively the holding in the target entity is relevant to the treatment of the entire holding structure in the case of "single-purpose entities".

Furthermore, we understand the provisions to mean that the relevant value to be used is the book value of the items.

Q02: Provisions included in paragraph 1 of the following Article 14a refer in particular to pension funds. These provisions have to be read in conjunction with the deductions referred to in Article 33 (e) of the CRR. Would you see any cases where there might be an overlap between the two types of deductions? Please describe precisely these situations and the nature of the problem.

We would like to make clear beforehand that we interpret the EBA's statements to the effect that double capital deductions and double securitisation of items are to be avoided at any rate. In this context we would also like to say that we welcome the EBA's statement regarding question 7 on page 66 of the Draft Regulatory Technical Standards — NEAR FINAL VERSION On Own Funds [Part 1] under the draft Capital Requirements Regulation (CRR): "The EBA agrees on the principle that assets that are deducted should not be subject to a risk weight."

Defined benefit pension funds

In our opinion, pension funds have to be considered for the deduction items from holdings in financial sector entities only in so far as the deduction obligation is not already covered by Art. 36 Para. 1 (e) in conj. with Art. 41 Para. 1 CRR. In order to avoid double deductions the process of offsetting of different types of deductions from pension funds should follow the amount of risk inherent in the relevant positions. This means as a first step for the purposes of Art. 36 Para. 1 (h) and (i) CRR, the deductible positions in financial sector entities (FSE) included in the pension funds are set off against the capital deduction for defined benefit pension funds in accordance with Art. 36 Para. 1 (e) in conj. w. Art. 41 Para. 1 (a) (net asset position). In cases where the positions in FSEs included in a pension fund are higher than the net asset position of the fund, for the purpose of Art. 36 Para. 1 (h) and (i) CRR the amount exceeding the net assets needs to be deducted from own funds, too.

In a second step, this exceeding amount reduces the assessment base for risk weighted assets (RWA) in the standardised approach as well as in the internal ratings based approach.

Example 1: pension fund EUR 1,000, of which financial sector entities shares EUR 100, net asset position EUR 200. For the purposes of Art. 36 Para. 1 (e) CRR, EUR 200 EUR has to be deducted as net asset position. For the purposes of Art. 36 Para. 1 (h) and (i) CRR, the FSE-positions included in the pension fund (EUR 100) are set off against the net asset position. According to this, no capital deduction results for the purpose of Art. 36 Para. 1 (h) and (i) CRR. The assessment base for RWA remains EUR 800.

Example 2: pension fund EUR 1,000, of which financial sector entities shares EUR 300, net asset position EUR 200. For the purposes of Art. 36 Para. 1 (e) CRR, EUR 200 EUR has to be deducted as net asset position. For the purposes of Art. 36 Para. 1 (h) and (i) CRR, the FSE-positions included in the pension fund (EUR 300) are set off against the net asset position. According to this, a capital deduction of EUR 100 results for the purpose of Art. 36 Para. 1 (h) and (i) CRR. The assessment base for RWA is reduced to EUR 700.

Q03: Please provide also some input on the potential impact? What would be the size of the deduction of defined benefit pension funds under the treatment proposed in the following Article? Would the treatment cause a change in the investment policy of the pension fund with regard to such holdings, or have any other consequences for the operation of the defined benefit pension scheme?

A) Change of investment policy?

Institutions may plan to change the investment directive for their pension funds in the way that investments in direct or indirect participations in capital instruments of the holding company of the bank should not be carried out.

B) Other consequences for the defined benefit pension scheme

The recognition of pension assets in conjunction with the implicit obligation to look through to single assets results in an enormous operative burden. The reason being that the trustees — that are entrusted with the management of those pension assets — act very independently. Reporting (e.g. for the purpose of annual reports) is often done by independent actuaries. Direct automatic linking of single transactions, which is required to look through to single assets is practically (and legally) not possible.

At the same time, the structured-based approach seems to be only applicable under the precondition that a look-through is too "operationally burdensome". RTS 2013-01 (near final draft) includes thresholds depending on the CET1 of the institution (2% for the individual net exposure arising from index holdings and according to the CP at hand also for all other indirect exposures, that refer to a multitude of underlying), 5% for the aggregated net exposure arising from index holdings that need to be looked-through, 10% for the aggregated net exposure arising from index holdings including all other non-significant investments) that are practically impossible to meet given the partly very high volumes in pension assets.

The consequence, which is to treat the entire intransparent position as a 100% investment in own funds, seems — especially for pension funds — disproportionate, based on the fact that the trustee is usually prohibited to directly invest in instruments of the institution to protect pension beneficiaries.

We would, therefore, welcome an extended approach to the application of the structured-based approach. In particular, we find that the limitation of the structured-based approach to cases which are "operationally burdensome" is not compulsory because the CRR provides this precondition only for indices to which the RTS 2013-01 is applicable. Accordingly, the EBA might use differentiated provisions for the following cases in the context of its RTS Part 3:

1. Where the bank can assure that the intransparent positions in general do not contain relevant investments (e.g. in the case of an intransparent pension fund), these cases are not a matter of fact of the present proposals for the treatment of holding deductions but are covered by the existing RWA set of rules in a way adequate to the risk.

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2. The further set-off as a non-significant investment is to be applied to items which provably do not contain external CET1 instruments; amounts of own CET1 items have to be deducted.
3. The own and external CET1 items are taken into account appropriately in the determination of the deduction items for results calculated at an aggregated level. The external CET1 investments are taken into account as significant investments.
4. The limits specified above of the RTS 2013-01 (near final draft) initially apply to completely intransparent items. They have to be deducted from the CET1 in the same way as investments in own shares. A grandfathering clause applies to items of existing pension funds established prior to 1 January 2014. This ensures that items where transparency cannot be created will not have to be deducted from the capital before 1 January 2024 but have to be weighted with 250%.

Q04: Do you agree with the examples of synthetic holdings provided in paragraph 2 of the following Article 14a? Should other examples be added to this list?

We agree to the proposed examples and welcome the consistency with the representations of the FAQ of Basel III. However, we ask to clarify that the list of the long positions does not mean that there are no corresponding, or offsettable, short positions.

Moreover, the approach regarding the various kinds of holdings should be explained further. For example, it is questionable with a view to convertible bonds how exactly bonds and options have to be taken account of, i.e. whether a breakdown of the individual instruments is necessary.

According to Art. 14a Para. 2 (d), "any other actual or contingent contractual obligation of the institution to purchase its own capital instruments" are likewise to be regarded as synthetic holdings. However, the current drafts of the COREP report sheets (as of March 2013) provide for a separate identification of synthetically held own instruments (e.g. CA1 item 091) and "actual or contingent obligations to purchase own CET 1 instruments" (e.g. CA1 item 092). Therefore, it should be delimited in the ITS on reporting which structures have to be recorded on the COREP report sheets at item 091 or at item 092.

Q05: Are the provisions contained regarding synthetic holdings in paragraph 2 of the following Article 14a and in Article 14e sufficiently clear? Do you agree that the amount to be deducted shall be the notional amount? Would you see any situations where another amount shall be used?

Article 14e:

The FAQ of the Basel Committee (question 15) make it clear that "in all cases, the loss that the bank would suffer on the exposures if the capital of the financial institution is permanently written-off is to be treated as a direct exposure (ie subject to a deduction treatment)". The proposed use of the "notional amount" for synthetic positions does not do justice to this basic intention of the provisions.

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For example, a notional amount is not agreed for forward purchases. Instead, the number of contracts, the multiplier and the exercise price as well as the current market value of the underlying are the relevant variables. In particular in the case of options, the use of the notional amount is unsuitable because this would neglect the likelihood of exercise of the option which is expressed in the so-called delta. Example: The institution has sold a put option for 100 bank B shares, the delta is 0.6. At the same time, a put option for 120 bank B shares was purchased, the delta is 0.4. The notional amount approach would result in the institution not having to report a deduction although in economic terms it is holding an open risk ($100 \times 0.6 - 120 \times 0.4 = 12$). If the delta-equivalent is applied, the resulting deduction amount would be 12 shares times current spot market value of the bank B share. This procedure would comply with Art. 329 para 1 CRR.

Also, when applying the notional amount, a reasonable net asset position is not formed. Example: The institution concludes a TRS for 100 bank A shares at t_0 (current market value EUR 100 = EUR 10,000 nominal value). At t_1 , it concludes a reverse TRS for 90 bank A shares (current market value EUR 120 = EUR 10,800 nominal value). The notional amount approach would result in the institution not having to report a deduction although it is holding a risk item in the amount of 10 shares. It would be better to use the market value of the underlying. In the example, the result would be a deduction amount of 10 shares times the current spot market value of the bank A share. Apart from that, this would precisely correspond to the procedure in accordance with Article 327 CRR for mapping the market price risk of shares.

The two examples above are shown in such a way that the supervisory mapping plays down the economic risks. However, scenarios can also be shown in which the economic risks are exaggerated. This is true in particular for options which are far out-of-the-money. Example: Out-of-the-money put option with residual maturity of 3 days — when physically settled (Art. 75 CRR). Using the notional amount does not seem prudent, as the maturity of the put is only 3 days and there is no economic incentive to exercise the put, except in case of a jump to default of the reference asset in the next 2 days. Using the delta equivalent instead results in a short position close to 0 that takes both the remaining maturity and the likelihood of exercising the put option into account.)

To enable control of the potential deduction from own funds at least rudimentarily, the requirements should be designed in such a way that, on the one hand, economically open positions are actually shown as such and, on the other, economically closed positions do not result in a deduction. Insofar, we suggest the use of the delta equivalent for transactions of an optional nature, as shown e.g. in Articles 280 and 329 CRR. To cover cases in which these two approaches appear not to be appropriate, the deliberations of the FAQ of Basel III on this subject (see above, first paragraph at question 5) should be taken up by EBA.

Q06: Are the provisions relating to the deduction of serial or parallel holdings through intermediate entities sufficiently clear? Do you see any unexpected consequences? Are there issues which need to be elaborated further?

1. Article 14c:

a) Calculation by tranches

We cannot comprehend the calculation by tranches as per Art. 14c (1) b) because it does not become clear why the calculation has to be done separately for the different tranches. The degree of complexity of the calculation increases without the benefit of this becoming clear. Therefore, a sample calculation should be added to make the intention and functioning clear. In particular, it should be considered in this regard that the individual claim items may involve different seniority levels. For possible sample calculations we point to the appendix to this document. The calculations there also show that the existing calculation formula sometimes leads to improper results.

The EBA Standard does not state whether the deduction is based on the book value and hence takes account of possible depreciation. This should be clarified.

Article 14f:

- To check whether an institution owns more than 10% of the Common Equity Tier 1 instruments issued by the financial sector entity, the institution shall add up the gross amounts of its direct, indirect and synthetic holdings in a financial sector entity in the form of instruments of the Common Equity Tier 1 and finally compare the sum to the Common Equity Tier 1 issued by the respective entity (Para. 1). This contradicts the wording of Art. 43 (a) CRR where the express condition is laid down that the institution **owns** more than 10% of the Common Equity Tier 1 instruments issued by the respective entity. That is, expressly only the direct holdings are made reference to there. Article 43 (a) CRR in particular addresses the specific effect on the investing entity in the sense of the holding of direct holdings. The EBA does not have a mandate for the proposed extension. Moreover, it is also not necessary because Art. 43 (b) and (c) CRR already cover the constellations of a significant holding (close links and consolidation for account rendering purposes) that are not based on direct participation.

Furthermore, we would like to point out that a different concept taking into account all net positions would not only lead to a discrepancy with the other 2 cases mentioned in Art. 43 CRR. It also would lead to a virtually insolvable operational and calculation problem. This results from the fact that the calculation of gross as well as net positions would be based on book values (direct and most indirect positions) and notionals (synthetic positions). For the calculation of the CET1 investment ratio they would have to be compared with the CET1 of the financial sector entity, which could be calculated based on the other entity's balance sheet, pillar 3 report, if available, or publicly available information on number of shares or subscribed capital. Almost certainly this will lead to misleading results that do not make sense from an economic perspective. A concept based on direct positions would allow one to concentrate on some special cases that could be calculated with way more accuracy.

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- If it is not possible to determine the exact amount of holding owing to missing information about the total amount of Common Equity Tier 1, the institutions should be allowed to use the “conventional” amount of holding, which is known from the holding reporting for instance. This should be clarified by EBA.
- A mere adding up of the (gross) long positions is not appropriate. This will provide a completely distorted view in particular of items of the trading book. Probably, many times the actually available real equities would be deducted. In addition, such an approach leads to very volatile positions which in particular would probably result in frequent changes of the status of a position between “significant” and “not significant”.

We, therefore, argue in favour of using only the direct holdings, in accordance with the provisions of the CRR, to determine a significant holding. The net long position should be taken into account for items of the trading book.

Article 14g:

As we understand it, the heading of this Article (“Holdings of additional tier 1 and tier 2”) is not appropriate, or ambiguous, because Art. 14g (2) also deals with the order of deductions for “Common Equity Tier 1 instruments”. We interpret the statements to the effect that the EBA’s aim here was to lay down the provisions for a “corresponding deduction approach” the objective of which is to base deductions on the respective capital classes of the target investments (and not the intermediates) and to regulate the order of deductions within the individual capital components.

Assuming this, we believe it to be reasonable to change the Article’s heading to “Corresponding deduction approach”. The first paragraph in its present form would do justice to this interpretation. The second paragraph, however, is in the current context and with respect to its wording ambiguous at best.

The proposed provision allows multiple deductions in the banking system. Example: The intermediate entity has 10 shareholders each of which is holding 100 of the equity capital. This intermediate entity has 300 CET1, 400 AT1 and 300 T2 own stock. According to the provision, each of the 10 shareholders would have to appropriate 100 CET1 deductions, i.e. a sum total of 1,000 (more than actually invested in CET1). However, it would be proper if each shareholder was required to appropriate 30 CET1, 40 AT1 and 30 T2 as deductions.

Furthermore, it is not comprehensible why Para. 2 is to apply to pension funds only. We, therefore, propose to adjust Article 14g as follows:

Article 14g

~~Holdings of Additional Tier 1 and Tier 2~~ Corresponding deduction approach

1. *The methodology outlined in Articles 14a to 14e will be applied to Additional Tier 1 holdings for the purposes of Article 53(a), (c), (d) (f) and to Tier 2 holdings for the purposes of Article 63(a), (c), (d) of Regulation xx/xx [CRR].*
2. *~~“For the purposes of Article 14a 1 b),~~ The corresponding deduction approach shall be carried out as follows within each tier of capital: in case the intermediate entity holds Common Equity Tier 1 instruments of the institution, those shall be deducted first. If the deduction of Common Equity Tier 1 instruments of the institution ~~to be deducted~~ as a result of the calculation above is less*

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than the ~~total funding provided~~ deductible exposure by the institution to the intermediate entity, ~~other~~ holdings of Common Equity Tier 1 instruments issued by other financial sector entities shall be considered for the deduction. For deductions of Additional Tier 1 instruments and Tier 2 instruments, similar principles shall apply. ~~Similarly, in~~

3. *In case the intermediate entity holds Common Equity Tier 1 instruments, Additional Tier 1 instruments and Tier 2 instruments of financial sector entities, and where the institution is not able to determine the maximum percentage for its investment in the respective tiers of capital, the Common Equity Tier 1 instruments shall be deducted first, the Additional Tier 1 instruments shall be deducted second, and the Tier 2 instruments last."*

[Drafting note: The term "corresponding deduction approach" is explicitly mentioned in the near final EBA RTS on Own Funds Part 1.]

Article 14h (Determination of the maturity of long positions):

The only exception from the general condition of the CRR, that the maturities of positions have to correspond with each other to enable a set-off, concerns cases in which the bank has a contractual right to sell a physical position and the counterparty is contractually obligated to buy them (Art. 75 CRR).

The EBA likewise addresses matching maturities in Article 14h. Deutsche Kreditwirtschaft welcomes this clarification of the application of the CRR rules relating to the netting of long and short positions. They are of substantial importance to the institutions.

- However, Article 14h should not just make recourse to the provisions of Art. 45 (a) CRR for the determination of the net long position for Common Equity Tier 1 instruments but also to the provisions of Art. 59 (a) CRR for instruments of the Additional Tier 1 Capital and to Art. 67 (a) CRR for instruments of the Tier 2 Capital.
- Moreover, we propose to not just provide a clarifying wording in respect of Art. 45 CRR which basically corresponds to the wording of Art. 75 CRR and apparently is likewise derived from the Basel FAQ. Both wordings exclusively refer to the set-off in cases in which physical delivery is agreed. However, transactions on a cash basis are identical to these in economic terms. Therefore, it is in the interest of the legislator to treat such so-called cash-settled products in the same way. They effect the identical economic safeguarding: if the long position fails before the short position ends, cash-settled derivatives fully compensate the loss incurred from the long position. Accordingly, it should be made clear that corresponding synthetic long positions are also covered by the rule. The rule should apply also where such a position does not arrange for a future cash sale but merely for a cash settlement.
- As regards the provision of Art. 76 CRR for the securing of long positions in single-name instruments by a short position in an index, it should be made clear in the RTS that the specifications also are to be applied to long positions in an index which is secured by short positions in single-name instruments.

Q07: Are the provisions of Article 14d relating to a structure-based approach sufficiently clear? Are there issues which need to be elaborated further?

In principle the provisions are sufficiently clear. It should however be clarified that the positions that have been looked through via structure-based approach should be recognised not only as significant holding position with risk weighting of 250% but also within the 10%/15% threshold for significant holdings. The treatment of intransparent positions as a 100% investment and therefore the application of a full deduction approach seems unreasonable.

Q08: Are the provisions of Article 24b sufficiently clear? Are there issues which need to be elaborated further?

The elaborations on "broad market indices" in Article 24b appear to be appropriate. However, they can only be applied to interest (rate) indices, while other indices such as share indices are likewise conceivable as a connecting variable for the amount of distributions on own funds. Therefore, we believe clarification is required that other market indices such as share indices are also admissible. The requirements relating to "broad market (interest) indices" would not be applicable to these where it is clear that the index will not rise if the credit standing of the issuing institution worsens and insofar the institution's interest payments will not increase.

Q09: What in your view is the best means for ensuring that the benchmark rate is not materially affected by the credit standing of an individual participating institution? The criterion of minimum number of contributors or that of minimum representativeness of the market or both?

No comment.

Q10: What would be the minimum number of contributors to ensure this absence of correlation? If a minimum representativeness of the market was chosen as an alternative route, how to ensure and calculate this representativeness? Would the percentage of 60% be sufficient?

No comment.

Q11: How would you treat minority interests arising from an institution permitted, under Article 8 of the CRR, to incorporate a subsidiary in the calculation of its solo requirement (individual consolidation method)?

We believe that sub-consolidation should apply. In case of a combination of subsidiary A (sub-consolidated) of B [that is a subsidiary of M] & A (solo consolidated) we would first apply solo consolidation and then sub-consolidation.

Q12: How would you treat minority interests arising from a subsidiary not subject to supervision on a sub-consolidated basis although it is the parent undertaking of other institutions? If the subsidiary would be allowed to undertake the calculation referred to in Article 79(1) on the basis of its sub-consolidated situation, some conditions would have to apply in order to secure this calculation in the absence of supervision on a sub-consolidated basis. What would you propose as conditions?

We understand the requirement of Art. 79 Para. 2 to mean that calculation has to take place at the sub-group level if, for the relevant level, regulatory subgroup accounts have to be prepared in accordance with Art. 20 CRR or the institution prepares them voluntarily or at the request of the local supervisory authority. In all other cases, the necessary calculations should be done at the single-institution level or as group contribution of the single-institution to limit the assignment of minority interests. At any rate, any obligation going beyond the provisions of Art. 20 to create additional regulatory sub-consolidation bases should be avoided. We do not see any additional benefit in this approach also compared to direct consolidation accounting.

We see the following problems here: The calculation of existing own funds for levels for which no corresponding (sub-) consolidated accounts are prepared causes unnecessary expenditure and usually cannot be implemented on the basis of existing accounting processes. Moreover, no audits are performed at this level and also the assignment of e.g. unrealised profits etc. is not regulated at these levels.

We understand that only minority interests of fully consolidated subsidiaries which are institutions or an undertaking that is subject by virtue of applicable national law to the requirements of this Regulation and Directive 2013/36/EU are addressed by articles 81 to 88 CRR. According to this, the restricted inclusion of minorities is to be calculated on a sub-consolidated basis for each subsidiary. Only that part of minorities may be taken into account as own funds which relate to that subsidiary and are required on a consolidated basis to meet the sum of the capital requirements.

What is not addressed is the question how to treat minorities of fully consolidated subsidiaries which are no institution and no other undertaking that is subject by virtue of applicable national law to the requirements of this Regulation and Directive 2013/36/EU. We assume that minorities from such undertakings which are not subject to capital requirements may be fully taken into account as own funds on a consolidated level.

Minority interests in intermediate holdings which are neither directly nor indirectly subject to the CRR, should be allowed to be taken account of at the level of the entity obligated to consolidate to the extent of Art. 81 Para. 1 CRR, provided the entity obligated to consolidate can dispose of the minority interests by way of contract or in actuality.

We ask EBA for clarification.

Q13: cross-cutting comments

Treatment of items for which a look-through is demonstrated to be impossible

On 5 June 2013, the European Banking Authority (EBA) published the near final version of its drafts of the first part of Regulatory Technical Standards on Own Funds under the Capital Requirements Regulation (CRR). The drafts already address issues regarding "indirect holdings arising from index holdings" (Article 17 and 18).

These proposals allow the institutions to deviate from the general look-through requirement (e.g. Art. 42 Letter b) for indices by applying a so-called "structure-based approach" to determine the value of the exposures, however, only under certain conditions if otherwise determination of the value would be "operationally burdensome". However, "operationally burdensome" indicates that a look-through is possible. Unfortunately, however, the EBA's proposals (RTS on Own Funds Part 1 and Part 3) do not adequately take account of the case that it is completely impossible for an institution to make a look-through. This may be the case e.g. where pension funds are held which do not disclose their holding positions. According to the regulations set forth, the impossibility of look-through will in that case result in the complete deduction of the item from the Common Equity Tier 1, which is not reasonable from the point of view of Deutsche Kreditwirtschaft.

Complete deduction appears to be reasonable only where the institution cannot rule out that a certain investment relates to own capital instruments or those issued by other financial sector entities. However, where the maximal exposure towards the financial sector can be determined for such items (e.g. based on the investment mandate), not more than that should be deducted. The deduction might be made in the highest capital class which cannot be ruled out in a particular case, i.e. where in doubt as own shares from the Common Equity Tier 1. We, therefore, suggest, to include a procedure for the treatment of these items in accordance with the methodology presented by us in respect of question 3 of this Consultation Paper and to extend the term "operationally burdensome" by this kind of case configuration.

Furthermore, the definition of the term "index holdings" in the above-mentioned Technical Standard is very wide as it encompasses not just indices but also "index includes, but is not limited to, index funds, equity or bond indices or any other scheme where the underlying instrument is a capital instrument issued by a financial sector entity." (Art. 17 Para. 1 *ibid.*). From the point of view of Deutsche Kreditwirtschaft, the EBA is exceeding its mandate at this point as the authorisation of Article 76 Para. 4 does not extend to the definition of the term "index holdings". In particular, substantial overlapping and inconsistencies with the present Standard, which addresses indirect holdings, arise from such a wide definition.

Definition of the term "financial sector entity"

Another problem is not directly connected with this Consultation Paper which, however, was addressed at the hearing on the draft RTS on 24 June 2013 and in respect of which the EBA working group has asked for written input:

Mixed Activity Holding Companies (MAHC) and Mixed Activity Insurance Holding Companies (MAIHC) appear to have been included in the definition of the term "financial sector entity" in Art. 4 No. 27 (i) and (j) CRR without foreseeing the effects of this alteration.

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Because: the definitions of MAHC or MAIHC also encompass parent companies which are not themselves part of the financial sector (such as automobile manufacturers or power companies) and fully assign them to the financial sector if they have even one subsidiary which is either an institution (e.g. an auto bank or an energy trader) or an insurance company — and this irrespective of the volume of such activities.

The inclusion considerably reduces the Common Equity Tier 1 in the case of institutions that hold shares in or lend money to such entities and at the same time, an increase of the risk-weighted assets of the institutions occurs. These provisions are not provided for by the Basel Committee and mean a considerable worsening of the competitive position of European Banks. The provisions of Basel III merely speak of "capital of banking, financial and insurance entities".

At the same time, these rules result in substantial disadvantages to the real economy entities affected: The credit terms for these entities, their access to fresh equity capital and the liquidity of their shares will considerably worsen. This will possibly affect the major part of the larger industrial and service provision enterprises as almost all of them have an institution or an insurance company as one of their group companies.

As a result, loans to these entities need to be backed with more equity capital of the lending bank (asset value correlation factor) and interests held in them have to be deducted from Common Equity Tier 1 of the bank investing in the share capital. This will mean stricter credit terms for these entities and their possibility to access equity capital, as well as the liquidity of their shares, will worsen because banks will no longer be able to invest in them.

We very much plead in favour of deleting the Letters i) and j) from the Level 1 text (of the CRR) and call on the EBA to support this petition vis-à-vis the Level 1 rule makers. Moreover, we suggest that the EBA draw up an interpretation aid for this provision in the form of a guideline which at least introduces de minimis thresholds that define levels beyond which a "Mixed Activity Holding Company" is active in the financial sector in such a way that classification of the entire group as a financial sector entity is justified. For reasons of practicability, the thresholds should relate to the group's balance sheet total, i.e. if the share of institutions in a mixed activity group exceeds a certain value, the entire group would have to be classified as a financial sector entity. As regards the amount, the U.S. rules might be used for orientation:

In these rules, a prerequisite for "financial institutions" is a main activity in the area of "financial activities" which is assumed to be given if either a minimum of 85% of the total annual turnover or a minimum of 85% of the balance sheet total result from financial activities.

Finally, from the point of view of Deutsche Kreditwirtschaft, the definition of the term "financial institution" is also too wide (Art. 4 Para. 26 CRR), namely in the subform "an entity which is not an institution and whose main activity is to acquire holdings (...)". According to the wording, pure holding companies that merely hold interests outside the financial sector and also do not deal with holdings might likewise be encompassed by this.

We, therefore, believe it to be appropriate to exclude the cases described in the paragraph above of pure industrial holding companies from treatment as "financial institution" for the purpose of capital deduction.

APPENDIX

Example regarding question 6, Article 14c:

In our opinion, the current version of the RTS is sometimes vague or results in multiple deductions:

Example 1:

Institution A holds EUR10,000 of CET 1 of the intermediate which has a total of EUR100,000 CET1.

Institution B holds EUR90,000 of CET 1 of I,

Institution C holds EUR10,000 T2 of I, I has a total of EUR20,000 T2.

I has invested EUR10,000 in institution D.

Deduction amount in acc. w. Art 14 c RTS:

Institution A:

Financing share: $10/100 = 1/10$

Amount acc. to. Art. 14 (1) b i: EUR10,000 (CET 1 instruments which I holds in D) – *lower amount*

Amount acc. to. Art. 14 (1) b ii: EUR100,000 (all CET1 instruments at I)

Deduction: $EUR10,000 * 1/10 = EUR1,000$

Institution B:

Financing share: $90/100 = 9/10$

Amount acc. to. Art. 14 (1) b i: EUR10,000 (CET 1 instruments which I holds in D) – *lower amount*

Amount acc. to. Art. 14 (1) b ii: EUR100,000 (all CET1 instruments at I)

Deduction: $EUR10,000 * 9/10 = EUR9,000$

Institution C:

Financing share: $10/20 = 1/2$

Amount acc. to. Art. 14 (1) b i: EUR10,000 (CET 1 instruments which I holds in D) – *lower amount*

Amount acc. to. Art. 14 (1) b ii: EUR20,000 (all T2 instruments at I)

Deduction: $EUR10,000 * 1/2 = EUR5,000$

Result:

A total of $(1+9+5) = EUR15,000$ has to be deducted although just EUR10,000 are invested in the target company D.

The institutions A and C each have invested EUR10,000 but in different capital classes. Although C has invested in a lower risk capital class, C has to deduct 5 times more than A. The RTS does not state that the indirect holding mediated via the tier 2 capital is to be deducted only from tier 2 capital.

The example shows that the existing wording leads to improper results. The EBA should recheck the meaning of the regulations based on concrete calculations.