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EBA - CP/2012/02 - Regulatory Technical Standards (RTS) on Own Funds

The Austrian banking industry is pleased to submit its comments on the Regulatory Technical Standards (RTS) on Own Funds. The comments provided herein, however, are subject to the outcome of the ongoing tripartite negotiations. The process of implementation is made all the more difficult since preparations are based on regulations that have yet to be determined.

Article 2

This Article is sufficiently clear.

- What needs to be pointed out, however, is that internally documented resolutions of the management body and the
- bank auditor's/auditor's confirmation suffice.

Article 4

Points (a) and (c) in Article 4 (2), in particular, undermine the draft CRR. The provision under Article 4 (2) (a), which states that a Common Equity Tier 1 item shall not contain an obligation to pay distributions, has already been implemented in Article 26 (1) h (v) and (vii) of the draft CRR.

Article 4 (2) c contradicts Article 26 (1) h (iii) and (iv) of the draft CRR.

We would therefore like to see the deletion of the relevant EBA-RTS in Article 25 CRR and, subsequently, of Articles 4 and 5 of the present draft EBA-RTS, as previously put forward in compromise proposals.

Article 4 (3):

We have problem with Article 4 (3) of the EBA standard as it also mentions redemption in active businesses, which is judiciously left unmentioned in Article 27 of the CRR. The limitation that the nominal value principle must apply to holders of all CET 1 instruments in order for the business interests to be recognised is impossible to implement in the event of redemption, once participation capital has been spent. According to sec. 102a (4) of the Austrian Banking Act (BWG), participation capital may only be redeemed upon payment of a reasonable consideration in cash. However, business interests cancelled by the member are redeemed at their nominal value. The issuance of participation capital must not lead to a loss in core capital quality in the business interests.

In light of ECOFIN's decision on the CRR, any mention of redemption in Article 4 (3) of the EBA standards should be deleted, since Article 27 (4) of the draft CRR - in the version of the ECOFIN decision - clarifies that issuing non-voting CET1 instruments does not prevent recognition of business interests as CET1 capital.

Article 6 – Q 1, 2

- We would require a clearer definition of “funding”. The wording in Art 6 (1) “loan or other funding in any form” is liable to be misleading, as it could be construed to encompass the donation of equity. We understand “funding” in the sense of liabilities and not equity. Equity would be treated under Article 33 (1) (g) CRR (“reciprocal cross holding”) and would be the corresponding requirement for holdings in equity.

We would suggest the following wording:

“Direct funding means situations where an institution has granted a loan or other funding <u>*to an investor in any form other than holdings*</u>, <u>*which the competent authority deems have been designed to artificially inflate the institution's own funds through*</u> the purchase of its capital instruments. The applicable forms and nature of indirect funding of an institution’s capital instruments shall include the following:

- In many of the cited cases, particularly in multi-stage credit relationships, the bank will not be able to assess what the loan is actually used for. The standard should use the prima facie purpose of the facility provided by the bank as basis. A bank can only be required to prove that a facility is not intended to finance an institution's capital instruments if there are objective reasons to suspect such a motive (e.g. chronological proximity).

- A supplement to letter a) in Article 6 (2) could clarify that not only a subsidiary's investments in its parent, but, where an institutional protection scheme is in place, a central institution's investments in related institutions cannot qualify as indirect funding. For instance:
  “(a) The investor is not included in the scope of prudential consolidation of the institution, nor in the scope of the supplementary supervision of the institution in accordance with Directive 2002/87/EC nor in the institutional protection scheme in accordance with Art 108. (7).

- Furthermore, any direct funding that artificially inflates own funds should also be considered inadmissible, as certain situations may arise where direct funding may have a legitimate and justifiable cause. Here we refer to Article 33 (1) (g) CRR which provides for a similar situation concerning reciprocal cross holdings.

- 1.(d) (ii) – Q 3
  Requiring a related party to have sufficient revenues on an ongoing basis would exclude clients with considerable other equity holdings that could be sold off to repay the funding without having to rely on revenues on an ongoing basis.
  Therefore, the wording of this provision should be amended so that the ability to support interest payments and repay the funding without recourse to the distributions on the capital instruments held are sufficient, regardless of the means by which this is managed.

  We would suggest the following wording:

  "the natural or legal person or the related party shall not have to rely on the distributions on the capital instrument to support the payment of interest and repayment of the funding"

- Ad Article 6 (4): Linking the extension of a loan with the subscription of capital instruments has been an established tradition among cooperative societies and we generally welcome explicit recognition thereof in Article 6 (4). If the requirements set forth under (a) and (b) have been met, the admissibility of a loan applicant's membership in a cooperative society cannot depend on whether membership is mandatory or whether the obligation to capital instrument subscription is set out in the articles of association. It must suffice for loan applicants to be invited as a matter of tradition without having any such rule inscribed in the articles of association. The condition specified in (c) is excessive, particularly as there are cases where cooperative societies require subscriptions that are proportionate to the borrowed amount.

Hence, the following wording would preferable:
"4. With regard to mutuals, cooperative societies and similar institutions, where there is an obligation or a tradition for a customer to subscribe capital instruments in order to receive a loan, that loan is not considered as a direct or indirect funding under the conditions that:

(a) the amount of the subscription in not material;

(b) the purpose of the loan is not the purchase of an institution's capital instrument;

(c) the subscription of *at least one of* the institution's capital instruments is necessary in order for the beneficiary of the loan to become a member of the mutual, cooperative society or similar institution."

- A definition of "material" is lacking here. Furthermore, it should read "is not material" instead of "in not material".

Question 4
Yes, they are sufficiently clear and there is no need for them to be further elaborated.

Article 14 - Q 7

Ad (3): We would strongly encourage not implementing any administrative procedures in view of a consent by the supervisory authority or similar. This should be left to the ongoing supervisory process.

Ad (4): The last sentence should be deleted. We cannot accept that banks calculating their eligible capital on the basis on local GAAP be required to apply IFRS. This should be left to the local GAAP regime.

Article 15-17 – Q 8 and 9

The described departure from the "corresponding deduction approach" is problematic when it comes to:

- third state investments: AT1 and T2 instruments would be unattractive if they need to be deducted from CET1. The formulation "coordinated equivalence assessment" appears to be highly restrictive.
- Facilities from financial institutions, i.e. leasing companies, that are not directly subject to the CRR.

Article 15 (3) (a)

A list of prudential regimes in third countries equivalent to that applied in the Union prepared by EBA and published on EBA's website would be fundamental to ensure that the corresponding deduction approach is applied to capital instruments held by third country financial institutions in a transparent and harmonized way in order to warrant a level playing field.

Article 18

Subject to a decision on the final wording of the CRR, we hold the following view:

With respect to b), we would advocate the inclusion of an optional aggregation method as indicated in Article 108 (7) CRR as one among the various calculation methods available. We would endorse a consolidation/aggregation method that comprises only the solo levels of the companies that enter into a contractual cross-guarantee scheme as required by Article 108 (7) CRR, since only these companies assume liability for the guarantee and the remaining companies are not included among the companies for the zero risk weight. We would strongly recommend avoiding any departure from the system set-up in Art 108 (7) CRR as that could lead to serious friction.

We would assume that no dual use of own capital will ensue.

Article 19

- If any misuse not covered by the current wording should occur in the future, amendments could be introduced. Point (f) of paragraph 2 should therefore be deleted as it contains the unspecified passage “in a way which suggests”. This would leave ample room for interpretation and would require time-consuming consultation with the local regulator before AT1 instruments could be issued. This again would not be in the interest of local regulators as it would make them liable for any damages arising from undue time delays or leakages.

- **Point (d) of paragraph 2**
  The incentives to redeem are too prohibitive in view of the desired conversion to equity (and hence a positive step towards better quality capital and recapitalisation).

  The write-down/write-up alternative, as proposed in the current draft, does not adhere to the principle of burden sharing as applicable in the capital waterfall model.

- Ad (b): In our view, the option to convert to equity at a specific point in time with a certain strike (similar to convertibles) would not really be an incentive to redeem and should therefore not be allowed.

Articles 20-22

Question 13. How would you assess the impact of the provisions to be applied to temporary write-downs and write-ups?

- AT1 holders would realise losses earlier than equity holders, resulting in lower coupon payments and principal losses, while equity holders could potentially receive dividends again.

- In the event of temporary write-downs, payments are excluded (point (1) of paragraph 3) as long as the loss in value has not been offset. This advantage over final write-downs appears unfounded and could lead to a reversal in the order of seniority. (shareholders receive dividends, payments of Tier 2 instruments are stopped).

  The example in the Annex clearly shows that AT1 investors will receive dividends later than equity investors, since, acc. to Art.20/3.(e) and (f) of the RTS, any distributable profit must be shared between equity and AT1 investors. However, profit allocated to AT1 investors cannot be distributed as long as the amount written-down is not written up again, whereas there is no write-up barrier for equity investors. This would mean putting AT1 investors at a disadvantage to equity investors.

- As indicated above, it is yet unclear which instruments will be subject to which treatment at which point of time. Will AT1 and T2 have the same trigger event or will they be different? Will the PONV be the same as the trigger event under Article 51 (a) (ii) CRR. How does this fit in with the point of entry into resolution and bail-in rules? How does this fit in with local insolvency law? How will all of this fit in with the rules of property protection of the ECHR? Is saving tax payer's money reason enough to at least partially expropriate equity, AT1 and T2 investors before an institution becomes insolvent in order to save other debt investors? As long as the details of risk allocation between the different own funds instruments (and maybe even junior debt) remains unclear, even equity markets will be reluctant to invest and the cost impact on issuers will remain high.

- The intention to allocate more risk to AT1 investors than to hybrid capital investors pushes out any fixed income investors who cannot take equity risk. Although this might be intentional for structured investment vehicles (SIVs being a part of the shadow banking system), it would not be for insurances and pension funds.

- On the other hand, equity investors might be more inclined to invest in real equity rather than AT1 instruments.

Article 20

Point (1) of paragraph 3: "all payments" - what requires clarification is whether all payments on AT1 instruments are to be recognised under the write-downs or payments on subordinated instruments as well (e.g. dividends to shareholders).

Article 22 (1)

As to the immediate notification of the instrument holders, we would rather recommend waiting for the amount to be written down (Art 21 (c)) to be determined before informing the holders.

Articles 25, 26

Question 15:
We do not agree with the proposed definition of "operational burdensome" since the definition given does not take into account operational aspects. In our view, consistency with the large exposure regime should be sought in order to contain the operational burden (especially by introducing a 5% threshold up to which a review in the event of granular schemes would be waivable).

Article 27

We would petition for the deletion of the last sentence and the middle part of the sentence “as assessed by the competent authority”. We see no additional benefit in referring to stress tests if the main rule requires at least an equal quality.

Articles 27 - 32

Question 18:
Prediction of market movements over such a time span is virtually impossible and will effectively jeopardize transactions that in fact improve CET1 ratios and were encouraged by EBA in the 9% exercise. Rather, such transactions should be performed within 4 weeks. Longer periods would raise the risk of leakage.

Question 20

We consider 5 years an appropriate time period.

Article 28

(1) The provision not to announce an expected redemption, reduction or repurchase of own funds instruments before approval may conflict with MAD requirements. This should be checked carefully.

Another question that arises with respect to publicly announced buybacks where – at the date of announcement – the final amount is not clear. We would therefore propose exempting these buybacks.

Article 29

Ad (a) of paragraph 3: The reference to the excess amount does not make much sense in the given context. Therefore, we would propose deleting this reference. Generally, it should refer to the 5% level as a level stipulated by the current legislation for market making. Article 19-24a of the Capital Directive (77/91/EEC).

This was again confirmed by 2006/68/EC and lead to a substantial liberalisation of the EU's specifications for own shares.
It is at the Member States' discretion to set a limit of no more than 10% for own shares that may be acquired.

Ad paragraph 4: For the sake of legal clarity the thresholds should not be lowered. We therefore propose deleting paragraph 4.

Ad paragraph 5: Information about ESOP (Employee Stock Option Program) and MSOP (Management Stock Option Program) of the supervisory authority seems to be burdensome in terms of administration and should therefore be skipped. We do not see any additional use for paragraph 5 anyway. Therefore, the whole paragraph should be deleted.

Article 30

Two things seem to have been confused here: on the one hand the buyback/redemption theme and on the other hand the market maker exemption. These two themes should not be confused when it comes to determining documentation requirements.

Article 31

Ad (1): A three-month period seems much too long. We would propose a shorter period of four weeks.

Article 32
The reference to excess capital should be removed here too (see above comments in Article 29).

Question 22 (page 48)

We are opposed to a 0% limit for equity in SPVs, i.e. support keeping the 0.5% limits in point (b).

Yours sincerely,

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