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J.nr.: 3013/003
Dok. nr.: 3013/003 HU-14-20-135212

24. januar 2014

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Lokale Pengeinstitutter (The Association of Local Banks, Savings Banks and Co-operative Banks in Denmark) comments to EBA´s draft RTS on Own Funds – part four (multiple dividends and differentiated distributions)

Copenhagen, 24 th January 2014

Lokale Pengeinstitutter (The Association of Local Banks, Savings Banks and Cooperative Banks in Denmark) is an association of 70 local banks, savings banks and cooperative banks in Denmark, The Faroe Islands, and Greenland. The circle of members includes practically all the Danish local banks with a distinctive local presence. By far the greater number of the association's members are also members of Finansrådet (The Danish Bankers' Association).

Taken as a whole the circle of members provide services via about 600 branches and employs a staff of 8.500. In the Danish private customers market, the Lokale Pengeinstitutter's market share is currently about 25 per cent. Among the small and medium-size commercial businesses, the market share is about the same.

Introductory remarks

Lokale Pengeinstitutter (The Association of Local Banks, Savings Banks and Cooperative Banks in Denmark) appreciates the opportunity to comment on EBA´s draft regulatory technical standards on Own Funds part four (multiple dividends and differentiated distributions).

We have the following comments on the issues raised in the draft:

Q1: How do you assess the suggested limits of 125 % under Article 7b (1) (a) and 105% under Article 7b(1) (b) for joint stock companies (non-joint stock companies, where applicable)?

We consider the two limits to be too restrictive.

If the "105%-rule" and the "125%-rule" were imposed on Danish NJS companies the consequence would be that the institutions would be financially weakened. Either the NJS companies would be forced to increase distributions to the class with the lowest distribution or alternatively the NJS companies would be forced to reduce distribution to the class with the highest distribution. In the former case there would be a drag on capital because of increased distributions to the total CET 1-capital and in the latter case there would be a drag on capital because the incentive to invest in high-yield classes would decrease significantly. If the existing terms of subscription cannot be maintained, there will be an imminent danger that the Danish savings banks capital base in the worst case scenario will erode and at best only remain stationary.

This is due to Danish NJS companies generally attracting capital up to a certain amount from the institution's customer base on very favorable terms. The distribution on this capital is around 3% per year. For higher amounts of capital distributions will be higher in order to attract the additional capital. The distribution on these major capital injections typically amount to factor 2-3 of the dividends paid to the capital receiving the minimum distributions.

All Danish NJS companies operate with differentiated distributions in excess of the 125 % rule and all NJS companies - except for one - operate with limits in excess of the 105 % rule.

In our view the two limits should be increased significantly bearing in mind that the capital base is already being protected by rules more suitably designed for such a purpose.

Q2: How do you assess the proposal to disqualify all dividend multiple instruments when the 105% limit is breached, for joint stock companies or non joint stock companies, where applicable? In which circumstances would this limit not work or be breached without the institution being able to prevent this breach?

In our view only capital instruments which exceed the two thresholds, should be disqualified from CET 1 capital. Such an approach would be similar to the general principle for in-

clusion of capital instruments in CET 1 capital where, for example purchases financed by the institution disqualifies those capital instruments being financed from inclusion in CET 1 capital but do not lead to disqualification of other parts of CET 1 capital. In our view it is important to model the "disqualification rule" in accordance with the very basic principle for inclusion of capital instruments in own funds.

Q5: Is the chosen approach applicable to all instruments that may be issued by non-joint stock institutions?

Article 7b, paragraph 9(b) introduces compliance assessment and information requirements for institutions each time new Common Equity Tier 1 instruments with fewer or no voting rights are issued. However, NJS companies are characterized by issuing new capital instruments continuously throughout the year reflecting the subscription of new capital instruments by customers on a frequent basis for typically a small amount of money. Reporting to supervisors each time new CET 1 capital instruments with fewer or no voting rights are subscribed would not be operational for either the institution or the supervisor. Instead, we find that the information reported under paragraph 9 (a) will be fully sufficient for monitoring compliance with the conditions in paragraph 5 and 6. Accordingly, paragraph 9 needs redrafting to reflect this.

Q6: How do you assess the proposed level of 30% for the payout ratio in paragraph 5(d) of Article 7b?

We find that the limit is too restrictive and should be removed or, alternatively, be raised significantly.

A limit of 30% imposes significant bindings on the opportunities for NJS companies to pay holders of capital instruments with a market standard return compared to JS companies. An investor in a NJS company receives distributions as the only return on the investment. An investor in a JS company receives distributions as well and in addition to that has an upside in form of a capital gain on the shares. Removing or raising the threshold of 30% significantly, would admit NJS companies ability to attract capital in fair competition with JS.

In Denmark, 10 NJS companies operate with differentiated distributions covering more than 80% of total assets in the Danish savings banks. A calculation for the last five year period 2012-2008 shows that all 10 NJS companies exceeded the 30% payout threshold with an average payout ratio of 65%.

Therefore, a payout limit of 30 per cent would lead all NJS companies operating with differentiated distributions to be included in the "105% rule" and "125% rule". However, all NJS companies operate with differentiated distribution in excess of 125 % rule as well, and all NJS companies - except for one - operate with limits in excess of 105 % rule.

It is noted that an average payout under 30% conversely implies that NJS companies must retain at least 70% of the accumulated profit over 5 years. We see no justification for such

a rulemaking for NJS companies which would have a major impact on the institutions business model and limit the opportunities for raising capital in fair competition with JS companies.

If the requirement for a payout restriction is maintained in the final RTS, we shall emphasize that the proposed calculation of the payout ratio as the sum of distributions related to CET 1 capital over the previous five year periods, divided by the sum of profits related to the same five year periods in effect imposes legislation retroactively. An institution's ability to make distributions would according to the proposal be limited by its historical financial performance which has been challenged during the financial crisis. Moreover, when institutions decided upon distributions they could not in any way foresee the rules for maximum distribution, which are now being proposed by the EBA.

Therefore, it is in any case necessary with transitional provisions or rulemaking according to which the maximum distribution at the outset is linked to the institutions present earnings instead of past earnings and on a forward looking basis is linked to an increasing number of periods until data for a five year period is available. This can be achieved by linking distributions in 2015 to present earnings in 2014 and on a forward looking basis linking maximum distributions in 2016 to earnings for the years 2014-2015 and maximum distributions in 2017 to earnings for the years 2014-2016 etc.

In contrast, for Danish NJS companies it would not be possible to link the maximum distributions for the year 2014 to earnings in 2013 within the limits contained in the final RTS on own funds – part four – because once the RTS on own funds – part four – is finalized the NJS companies will already have paid out distributions without knowing the final rules in the RTS on own funds.

To support our view that the proposed 30% limit is too restrictive and should be removed or, alternatively, be raised significantly, we shall finally emphasize that the CRD IV and CRR already contain provisions which are modeled to protect capital, including the capital conservation buffer and the countercyclical buffer, both of which contain limits concerning maximum distributions.

Q7: please provide data on the distributions on instruments as well as possible references to be used as benchmarks for the distributions on voting instruments issued by non-joint stock companies. How would you assess that distributions on voting instruments issued by non-joint stock companies are low? Can you suggest a methodology?

The following table shows payout ratios for the 10 Danish NJS operating with differentiated distributions (calculated as the sum of distributions related to CET 1 capital over the previous five year periods, divided by the sum of profits related to the same five year period).

Payout ratio	5-year period 2012-2008	5-year period 2011-2007	5-year period 2010-2006
Institution 1	44%	39%	25%
Institution 2	-	41%	18%
Institution 3	66%	66%	56%
Institution 4	-	-	-
Institution 5	-	-	89%
Institution 6	50%	27%	17%
Institution 7	126%	83%	31%
Institution 8	35%	25%	14%
Institution 9	68%	55%	36%
Institution 10	-	-	41%
Simple average	65%	48%	36%

No figure in the table above means an accumulated deficit over the 5 year period.

The figure shows the following:

- For the five year period 2012-2008 all 10 NJS companies exceed the 30% payout threshold with an average payout of 65%
- For the five year period 2011-2007 8 out of 10 NJS companies exceed the 30% threshold with an average distribution of 48% and
- For the five year period 2010-2006 6 out of 10 NJS companies exceed the 30% threshold with an average distribution of 36%.

Two Questions to EBA

1. According to the proposal it is possible for an institution to issue CET 1 capital instruments with few or no voting rights under specified conditions. However, we are uncertain whether the rule would allow NJS companies to operate with more than two classes of CET 1 capital instruments where distributions within each class is identical, but each class receives different distributions. As an example, assume that distribution to the voting capital instruments is 3%, distribution to a class of semi-voting capital instruments is 4% and distribution to a class of non-voting capital instruments is 5%. Could the EBA please specify either via the text in the RTS on own funds or via feedback to us if it would be possible for NJS companies to operate with three or more classes of CET 1 capital instruments where the distribution within each class is identical, but each class receives different distributions.

2. According to CRR, article 28 (4) "differentiated distributions shall only reflect differentiated voting rights". However, Danish NJS companies that operate in more than one class of capital have traditionally linked differentiated distributions to other factors than voting rights, including the amount of subscribed capital.

Now, the Danish NJS companies, of course, have to link differentiated distributions to differences in voting rights in accordance with CRR.

Could the EBA please specify in a feedback to us – if appropriate – if it would be considered within the CRR rules to combine the criterion of different voting rights with an additional criterion that must also be met in order to qualify for the class with the higher distribution.

As an example, assume that distributions on voting capital instrument is 3%, distributions on a class of semi -voting capital instrument is 4%, but to qualify for this class the customer as an additional criterion has to subscribe capital for x currency units, and distributions on a class of non -voting capital instrument is 5%, but in order to qualify for this class the customer as an additional criterion has to subscribe capital for (the bigger amount) y currency units.

Would the above mentioned approach be in accordance with CRR, article 28 (4)?

Thank you in advance.

Please do not hesitate to contact us if you need any further information.

Yours sincerely,

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