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28 September 2012

EAPB position on the EBA Draft Regulatory Technical Standards (RTS) on the specification of the calculation of specific and general credit risk adjustments (EBA/CP/2012/10)

Dear Sir or Madam,

The European Association of Public Banks (EAPB) is pleased to provide a response to the European Banking Authority's (EBA) consultation paper on Draft Regulatory Technical Standards on the specification of the calculation of specific and general credit risk adjustments according to Article 105(4) of the draft Capital Requirements Regulation (CRR). Below, please find our remarks on the key issues of the consultation paper.

In the consultation paper, credit risk adjustments are considered eligible if they both reduce the bank's Common Equity Tier 1 capital and, with reference to the applied accounting rules, reflect losses exclusively related to credit risk (Article 2(1) RTS). In our view, the principles of the requirements are appropriate. However, it should be made clear that Common Equity Tier 1 capital in line with Article 2(1) RTS is already reduced in case the credit risk adjustments are accepted in the profit and loss accounting as an expense item of the respective credit institution. A reported loss equivalent in volume should not be seen as a condition for eligibility as profitable institutions would otherwise be penalized for bearing lower credit risk adjustments.

In this respect, it is very important to take those valuation allowances into account which are not yet subject to the profit and loss statement. In the view of EAPB, not considering such valuation allowances would lead to an unjustified disadvantage for those banks which do not set up a quarterly statement. The valuation allowances are part of the institution's determination of current losses which must be deducted from Common Equity Tier 1 capital according to Article 33(1a) CRR. The EBA should clarify that it is sufficient to take these provisions into account for determining current losses. Here as well, current losses

equivalent in volume cannot be considered a condition for eligibility as this would unfairly penalise profitable institutions.

On 15 May 2012 the Council advocated in its general approach on the CRR to not only take into account general and specific credit risk adjustments for the treatment of expected loss amounts according to Article 155 CRR but also additional value adjustments in accordance with Article 31 CRR and Article 105 CRR and other adjustments which reduce the institution's capital. The EAPB would like to support the Council position. This includes, in our view, valuation adjustments in accordance with Article 100 CRR as far as they are allocated to banking book exposures that are subject to fair value measurement. In our view, it should be made possible to take these adjustments into account for the treatment of expected losses according to Article 155 CRR.

How to precisely carry out the comparison between credit risk adjustments and expected loss amounts is not yet defined. The remaining ambiguity is a result of the provisions of Article 155(3) CRR according to which specific credit risk adjustments for defaulted exposures cannot be used to back expected losses on other exposures. In our view, this makes a uniform application of the valuation allowance comparison impossible. Instead, we recommend the following:

As a first step, expected losses for all defaulted exposures should be offset by the respective specific credit risk adjustments (first step comparison). If this leads to a surplus this surplus cannot be used to back expected losses of non-defaulted exposures. However, it can be taken into account as Tier 2 capital according to Article 59d CRR. In case of a deficit this deficit should be part of the total valuation allowance comparison.

Subsequently, the expected losses of the non-defaulted exposures should be offset by the respective credit risk adjustments and the total of general credit risk adjustments for all exposures. This second step comparison would, together with a possible deficit in the first step comparison, account for the total valuation allowance comparison.

Yours faithfully,

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