EBA/CP/2012/02: Consultation Paper on Draft Regulatory Technical Standards on Own Funds (Part one)

Dear Sir,
dear Madam,

the German Banking Industry Committee (GBIC) welcomes the opportunity to provide comments to EBA/CP/2012/02: Consultation Paper on Draft Regulatory Technical Standards on Own Funds (Part one). Please find our remarks on the following pages.

We remain at your disposal for any further questions or request for information.

Yours sincerely,
on behalf of the German Banking Industry Committee
National Association of German Cooperative Banks

by proxy

Dr. Holger Mielk

Enclosure
Comments

"EBA Consultation Paper on Draft Regulatory Technical Standards on Own Funds – Part one (EBA/CP/2012/02)"

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The standards that have been submitted are based on the Commission draft CRR of 20 July 2011. Potential changes resulting from the forthcoming parliamentary process are naturally not contained hereunder. In our understanding, after submission of the final CRR, the standards will be reviewed in light of the provisions contained under said CRR before the standards will be submitted for a further consultation round.

1. Art. 2

Response to Q1:
The wording under indent 4.2: "in the opinion ... it is likely ..." should be specified in greater detail so that the discretionary correction by the supervisory authority will be subject to the presence of certain evidence. This means that the possibility for correction should only exist if the institute has already (repeatedly) violated its own dividend policy in the past. At any rate, it should be ensured that a mere one-off digression from an adopted dividend policy will not authorise the supervisory authority to exercise its corrective right. Otherwise, under the provisions set forth by indent 4(b).2, already a singular deviation from the defined dividend policy would incur the danger of a corresponding correction by the supervisory authority.

Indent 4.2(a) should be deleted. The calculation of dividend payout ratios as a long-term average appears inappropriate. This has become particularly obvious during the crisis between 2008 and 2012. Whilst the predication on prior year payments (lit. b) may be appropriate under certain circumstances, it should, however, be possible for the institute to adjust it (cf. proposal under sentence 3).

Apart from this, it would be helpful to have a further concept clarification concerning the specific meaning of "exceptional dividends" (indent 4.3). Should this refer to special dividends on special occasions (e.g. anniversaries etc.). And which criteria should be the constituent elements of a bank's jurisdiction in this regard?

Furthermore, paragraph 7 requires the competent authorities to sign off in advance of the institution including interim or year-end profits in Common Equity Tier 1 capital. Given that the draft guidance is clear and relatively prescriptive, it should be possible to agree the general approach with the competent authority on implementation. Otherwise a consent process would be required before the preparation of quarterly COREP reporting.

Banks which have not issued any capital in the form of shares and whose payouts, for instance, are being measured as a percentage of the capital previously made available should be granted the option to determine the pro rata payout ratio on the basis of their business planning and without an official dividend policy. Furthermore, in order to take account of the fact that the payout is akin to interest, there should be an accumulation [period] that is modelled on [the method of] interest deferrals. This is due to the fact that a payout ratio cannot be determined in meaningful manner through comparison with the profit/loss for the year-to-date but only by reference to the capital that has been made available.
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2. Art. 5

Comment:
We would like to point out that the preliminary draft still included the word “or” between “losses” and “diminish ability...”. At present, however, this word is absent from the official proposal. In our view, this was merely an editorial oversight. The current wording is clearly more restrictive than the original version. This is due to the fact that, now, the occurrence of substantial losses will have to significantly diminish access to liquidity or capital. Contrary to this, the previous version did not make this a condition precedent. Instead, it referred to this as an alternative, meaning that one of the two alternatives was sufficient for assuming “market stress”.

3. Art. 6

Comment:
Even in view of the explanatory text for consultation purposes which clarifies that any reference shall be understood in terms of substance, the reference to the IFRS in indent 1(d)2 is unacceptable in its current form. In order to achieve a neutral framework, potentially, the regulatory substance would then have to be carried over from section 9 of the IFRS by means of a verbatim quote and, potentially, its fitness for purpose would have to be discussed. The current proposal, however, places those banks which do not use IFRS at a disadvantage.

Response to Q2:
The categorisation as relevant indirect financing should be made subject to whether the action of the funding institute can be regarded as purposeful and in pursuit of a specific objective. Hence, for instance, it would make sense to adopt corresponding terminology such as “deliberately” or “intentional”. In this context it is striking that the corresponding condition precedent for purposeful action is taken for granted in the event of direct funding (cf. indent 1.1: "... for the purpose...") whilst this corresponding qualification can no longer be found in the event of indirect financing. Yet, without this qualification, the form and nature remains completely vague. After all, more often than not the funding institute is absolutely unaware of the ultimate use to which the funds borrowed by third parties will eventually be put.

In the final analysis, in order to avoid excessive aggravations for de minimis cases, a materiality criterion should be introduced. To this end, indent 1(b) should be supplemented: “(…) secured in some other way so that MATERIAL credit risk is transferred to the institution (…)”.

Response to Q3:

In the context of Article 6, the presentations under indent 1(d) and indent 4 appear out of place. Article 6 explicitly seeks to regulate and cover “indirect payments”. This is the only constellation that is covered by the legal mandate conferred under Article 26(3)(a) CRR. Contrary to this, the presentations under indent 1.2(d) regulate crediting of related parties and legal persons (loans extended to closely associated
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persons or companies) which do not fit into the context of this RTS because they cannot be regarded as indirect funding. Also the cases regulated under indent 4 do not involve indirect payments because these invariably require the intermediation of a third party. At this juncture, it is rather more about a direct transfer from the customer to the bank or conversely, from the bank to the customer. Thus, this constitutes a direct payment. Hence, th[e regulatory scope of these presentations ]is no longer covered by EBA’s legal mandate. Therefore, indent 1(d) and indent 4 should be deleted.

4. Art. 7

Comment:
Even though we do not agree with the proposed legislative text, referring to “distributable items”, the provisions of article 7 are sufficiently clear. Nevertheless, we think that for the sake of clarity it would be much better to clearly stay away from the legal definition of “distributable items” in contrast to the way, Commission’s CRR-text is unfortunately doing it.
Defining the concept of distributions neutral – in line with the requirements for the maximum of distributions as defined in the CRD in the context of buffers would be much more straightforward.
It would, however, be useful for the proposed Regulatory Technical Standard to address the situation of coupons that are distributed on the basis of Additional Tier 1 instruments that need to be qualified as debt from a legal point of view (and for which coupons may not be paid “out of” distributable items as these are reserved for shareholders).

5. Article 11 to 14

Response to Q7:
Paragraphs 3 and 4 of article 12 should be amended to clarify that exclusion from DTA/DTL offsetting should be limited to those associated DTL, as referred to under Article 35 of the CRR, that have been already used to reduce intangible assets and defined benefit pension fund assets. Insofar as associated DTL arising from intangible assets and defined benefit pension fund assets have not been used to reduce intangible assets or defined benefit pension fund assets, they may be used for offsetting under Art. 35 (3) and Art 35 (5) of the CRR. The respective rules of Art. 35 CRR are intended to prevent a double counting of DTL.

As regards the provisions under Article 13, it remains unclear which mandate EBA actually uses or, moreover, complies with under the RTS. When reading the RTS one obtains the impression that it is primarily about compliance with the mandate under Article 38(2) CRR. This, for instance would be specifically indicated by the reference in the “legal basis” in the heading of the article. Yet, on the other hand there is equally a reference to Article 33(2)(a) of the CRR which stipulates that the details on Article 33 (1)(e) of the CRR should be described hereunder.

We believe that the possibility of reducing the amount of defined benefit pension fund assets (DBOs) by those DBOs for which the institution has an unrestricted ability to use is economically viable. However the reduction by those DBOs should not rely on the (prior) consent of the competent authority. We therefore suggest the deletion of this part.
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Last but not least, within the regulatory framework, the editorial style for highlighting quotes from the IFRS Regulation should be standardised (cf. for instance the quote in Article 6, indent 1.2 (d) as opposed to the quote in Article 14, indent 2 and indent 4).

6. Article 15 to 17

Response to Q8:
Provided we are not mistaken in our following interpretation, the presentations are sufficiently clear: We understand that the corresponding deduction approach is always applicable where the entity in question would be classified as a “financial institution” under article 4 paragraph 3 CRR, irrespective of whether this leads to supervision on a single entity or on a group level, and also irrespective of whether the entity is in fact subject to supervision (or e.g. an exception according to CRR is applicable).

With regards to the assessment if the financial institution is subject to prudential requirements equivalent to those applied by institutions under the CRR, we assume that the EBA will publish a list of all countries that have similar prudential regimes in place. Otherwise the assessment, if the corresponding deduction approach can be applied, is not economically feasible and in some cases just impossible to conduct. The same holds true for a list, to be published by EIOPA with all countries that have a similar prudential regime in place for insurance and reinsurance undertakings.

In our understanding, as long as EBA has not published a binding list, the lists of countries which have a similar prudential regime in place prepared by the competent national supervisors which are available already today should remain in effect and ought to be applied.

We understand that for holdings in capital instruments of institutions within the meaning of article 4 paragraph 4 CRR the corresponding deduction approach will apply.

We understand that for holdings of capital instruments in insurance undertakings (not subject to Art. 17 RTS) the corresponding deduction approach will apply.

Response to Q9:
In case a capital instrument of a financial holding has to be deducted from CET 1 because the institution cannot determine if the financial institution is subject to prudential requirements equivalent to those applied to institutions under the CRR (e.g. there is no list of countries with similar prudential regimes) institutions would, as a result, no longer invest in capital instruments of financial institutions outside the European Union.

In our view, the RTS go beyond their mandate, as a corresponding deduction approach is only allowed for certain types of entities that are subject to a specific kind of supervision (EU or subject to third-country prudential requirements equivalent to that). This is overly punitive. To apply stricter requirements for financial institutions, third country insurance and reinsurance undertakings, and undertakings excluded from the scope of Directive 2009/138/EC - compared to e.g. credit institutions or investments firms -
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does not make sense. It is in particular not justified by "double gearing"-concerns (which would be relevant for institutions).

Moreover, the proposed Art. 16 and 17 are not in line with Art. 70 CRR: "Institutions shall not deduct from any element of own funds holdings of a regulated financial entity within the meaning of paragraph 2 of Article 137(4) that do not qualify as regulatory capital of that entity." Pursuant to Art. 137 (4) CRR, the definition of regulated financial entity also includes third country entities, inter alia insurance undertakings (Art. 137 (4) (a) (iii) CRR).

Contrary to these provisions Art. 16 and 17 of EBA’s draft standards require the deduction of "(a) all instruments qualifying as capital under the company law applicable to the issuer; (b) any dated and undated subordinated instruments" - irrespective of whether they qualify as regulatory capital of that entity.

The general treatment should be the other way round: in the first place application of a corresponding deduction approach (and only where this is not feasible application of stricter deduction requirements).

7. Art. 19

Response to Q11:
The first three examples listed are in line with the presentations in the Basel Committee’s FAQ. The next three examples, on the other hand, are new. Particularly the scenario under indent 2(e) of the RTS seems to merit a reality check. After all, the remarketing prospect does not lead to a capital refund or payment within the meaning of "redeem" or, moreover "redemption". Hence, on the part of the institute there is no capital payment at all. It is worth highlighting that this context generally boils down to the question whether a scenario involves "permanence" of own funds. Yet, in the constellation which is referred to at this juncture this criterion is not spurious meaning that the example chosen is inappropriate in this specific context. Hence, this example should be deleted from the list.

In principle, we agree on the types of incentives to redeem. The existence or non-existence of an incentive to redeem should be assessed at time of issuance once the CRD IV-package is enacted. In addition, we suggest that this assessment should be carried out by the relevant competent authority.

As for existing instruments (for grandfathering purposes), we suggest to take into consideration the possibility that a contractual step-up might nevertheless not constitute an incentive to redeem, as the interest rate including the step-up might still be low compared to actual spreads that would have to be paid in case of the issuance of a new instrument.
8. Article 20 to 22

Questions 12 and 13 should be considered in the overall context of the capital structure comprising of CET1, AT1 and Tier 2 as well the requirement to respect the capital hierarchy at all times.

Response to Q13:

We understand the general approach of the RTS to give a priority on write-up over distributions on (temporary written down) AT1 to restore the capital position of the institution.

However, we do not share the view that giving the write-up of temporary written down instruments a priority over distributions on CET1-instruments would hinder the recapitalisation of the institution. We see no conflict with new shareholders if "old" AT1-instruments are written up as quickly as possible. Even to the contrary, when the institution is on the way to full recovery and the prevailing situation allows it in line with the capital restoration plan, it is to the best interest of shareholders to have a quick write up:

- the minimum capital requirements need to be fulfilled at any time. If there is no AT1-capital available to fulfill the 1.5% AT1 layer, it needs to be filled by CET1;
- the above mentioned CET1 would therefore be not at hand to meet the "combined capital buffer" ("CCB") requirements which need to be met by CET1;
- if the CCB are not completely filled, restrictions on distributions prevail and neither AT1 – and what is more important – nor (new) CET1-instruments receive (full) distributions.

It is therefore of utmost importance for issuing banks to have the possibility to give write ups a priority over distributions. This would enlarge the universe of potential investors as best as possible. Otherwise the consequence would be that

a) issuance capacity for AT1 instruments is significantly reduced as a sizeable portion of fixed income investors stay away and

b) the institution is required to issue even more CET1 resulting in a higher dilution of existing and new shareholders and even fewer possibilities of distributions on CET1, leading to a more pronounced situation of hindering recapitalisation.

In conclusion, we are of the opinion that there should be no restrictions on the distribution as long as the institution meets or exceeds the CCB requirements (according to article 131ff). The institutions should be free to decide how to allocate distribution among the various capital layers.

Once an institution does not meet the CCB requirements article 131ff sets out restrictions on distributions. Distributions are still possible as long as the quantum distributed does not exceed the prescribed Maximum Distributable Amount ("MDA") and the distributions are paid out of appropriate funds. However, when an institution is subject to MDA limits, it is required to prepare a capital restoration plan that outlines how it will repair the CET1 ratio. The plan is vetted by the competent authority, so the institution will not have an unfettered ability to utilise the MDA and competent authorities have the option to intervene at any point in time.

- Besides this issue we see temporary write-down and write-up adequately applied. This would allow structuring an instrument that is feasible for debt investors.
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Response to Q12:

Article 20.1:
We agree with the provisions laid out in Article 20.1 for the amount of write-down of the principal amount. However, we see Article 20.1 b) conflicting with applicable accounting standards.

- Article 20.1 b) requires that a write down shall lead to an increase in equity, under the relevant accounting standards, that is eligible as CET1 Capital pursuant to Article 24 of the CRR. Similarly, CRR Article 51.2 says "Write down or conversion of an Additional Tier 1 instrument shall, under the applicable accounting standard, generate items that qualify as CET 1 items."

- It should be noted, that this requirement tries to link regulatory terms and accounting terms in a way which is not entirely appropriate:
  - According to IAS 32 AT1 instruments will qualify as equity (equity = residual amount). A write down of equity is not intended by IAS 32. What is more, IAS 32 does not make use of the sub-categories "Common Equity Tier 1" or "Additional Tier 1". The formal write down would not lead to a financial write down of the liability that increases profit and subsequently retained earnings, nor would there be any other reclassification within equity that could be seen as creation of CET1.

- In terms of an IFRS perspective the new requirement in Attn. 20 (2) lit. b as well as in Art. 51.2 E-CRR does not make sense. As a consequence the requirement should either be dismissed or amended. In the latter case it should be sufficient if information on the formal write down is provided to investors even if the formal write down is not relevant for the applicable accounting standard.

Articles 20.2 & 3:

In circumstances where an institution has recovered and CET1 ratio is above the trigger level, but does not yet meet the CCB requirements, AT1 with temporary write-down will according to the draft EBA RTS not receive coupons while they are written down. The priority is set for a write-up of the instrument rather than a distribution on the written-down notional.

This implies a situation not properly reflecting the capital hierarchy of an institution:

(a) AT1 holders of written-down instruments are not in a position to receive distributions on the written-down amount.

(b) Article 49 of the CRR allows a situation where a temporarily written-down AT1 instrument is written-down forever (and, therefore, does not receive a distribution) even though the institution has fully recovered and resumed payments on all other capital securities.

The combination of (a) and (b) severely hampers both the market capacity for AT1 and the costs for the issuers, thereby hindering a recapitalisation by placing more pressure on CET1.

In order to properly reflect the capital hierarchy we therefore suggest the following changes to the treatment of written-down AT1 and the write-up mechanism:

(a) AT1 holders of written-down instruments, should in general also be in a position to receive distributions on the written-down amount once the situation of the institutions allows it (i.e. the principal amount should not need to be written-up in full before coupons are resumed).
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(b) There should however be a priority of a write-up over distributions (i.e. dividends and payments on AT1 instruments) meaning that if written-down AT1 instruments are not being written-up by the maximum allowable amount as defined by the RTS, the entire MDA should be retained. This reinstall the capital hierarchy insofar as AT1 instruments subject to a write-down are either being written-up as quickly as possible within the restrictions given by the MDA and the RTS or they are in a position to receive a coupon on the written-down amount at the same time distributions to other capital instruments are being made out of the MDA.

Reduction in CET1 ratio due to a change in RWAs

Any reduction of the CET1 ratio due to an increase in RWA will be solely borne by investors in AT1 (i.e., this change will not impact equity holders unless it necessitates a new equity raising). Thus, in respect of RWA changes, AT1 holders are most likely subordinated to equity.

Specific comments on TITLE II Chapter 2 Section 2 Article 20 of the RTS

With respect to the treatment of instruments with permanent vs. temporary write-down laid down in Article 20.2 and 3, it should be ensured that there is equal treatment:

- It should be possible for an instrument which is temporarily written-down to have a write-up at least by an amount that is equivalent to a distribution on the reduced principal amount as allowed for an instrument with permanent write-down (according to Article 20.2).

- Although this provision is in line with the original requirement contained under CEBS’s CP 27, it still remains unclear why indent 3(a) stipulates that in the case of a temporary write-down, as a general rule, all of the instrument’s interest payments have to be cancelled until the initial nominal amount of the instrument has been fully reinstated whilst in the event of a permanent write-down, interest payments may be paid. The rationale behind this unequal treatment is not immediately obvious. Rather, it leads to an unequal treatment within the AT1 instruments which ought to be avoided lest it will deter investors from any further investments into these instruments.

- Having this in mind, we agree the write-up of AT1 should be prioritised over payments of coupons, but this concept should be extended to dividends and payments on AT1 instruments in general. When the CCB are met, Article 131(1) should apply, i.e. distributions and write-ups should be possible in general as long as the combined amount does not lead to a CET1 capital level no longer meeting the CCB. As a consequence, any restriction on the amount of a write-up as intended by 20(3)(e) should not apply when the CCB is met i.e. the write-up should not be limited when the institution has a CET1 ratio above the CCB and there are appropriate profits.

- Furthermore, we agree with Article 20(3)(f) of the RTS that a write-up should be treated as a distribution under the MDA or, in case where the institution has a CET1 ratio above the level required by the CCB, a distribution by the institution. However, a write-up should be treated in the same way as a distribution in all respects i.e. (a) fully discretionary and (b) independent for the different instruments given that neither dividend stoppers nor pushers are considered feasible. To put it another way, we consider that there should be full freedom for institutions to decide on write-up, dividends and/or payments on AT1 instruments (provided that in all circumstances the requirements of Article 131ff are not infringed).
We like to stress that in the context of AT 1 instruments with temporary write-down and the provision in Article 20.3 a priority of write-up over dividends is of particular relevance:

- We agree that it is suitable for an instrument with temporary write-down that is written-down, the emphasis should be on a write-up (and hence restoring the AT1 capital layer and loss absorption potential beyond the CET1 trigger level) rather than making payments on the written-down amount.

- However, it should be ensured for the AT1 investors that they do not end in a situation, where the instrument continues to be written down (and consequently neither payments can be made nor there is an investor option to redeem the instrument), but the institution already starts paying dividends. Given the requirement that all distributions (and this includes write-up) are fully discretionary, this possibility exists.

- Hence, we disagree that payments on AT1 instruments written down temporarily should be cancelled in general. To ensure equal treatment with shares and AT1 instrument with permanent write-down, payments for AT1 instruments written-down temporarily should be feasible insofar they are in line with the concept of “priority of write-up over dividends and payments on AT1 instruments” as outlined in the following. Allowing a priority of write-up over dividends would avoid the disproportionate situation for AT1 investors:
  - An institution would have a vital interest to restore the combined capital buffer so that it can freely decide on distributions (assuming an adequate profit situation) and hence satisfy the expectations of all its investors. This interest is absolutely in line with the interest of the relevant competent authority.
  - AT1 holders are ensured that, while payments are still fully discretionary, they will not be negatively treated as described above. Any profit not used for dividends, write-up or even payments for AT1 in a “fair manner” will have to be retained. Hence the hierarchy of capital instruments is adhered to.

We therefore propose to amend the EBA RTS Section 20(3) follows:

3. For the write-down to be considered temporary, all of the following conditions shall be met:

(a) all payments after a write-down shall be based on the reduced amount of the principal and be subject to points (f) and (g);

(b) write-ups shall be based on profits after the institution has taken a formal decision confirming the final profits;

(c) any write-up of the instrument shall be operated at the full discretion of the institution subject to the constraints arising from points (d) to (f) and there shall be no obligation for the institution to operate or accelerate a write-up under specific circumstances;

(d) a write-up shall be operated on a pro rata basis among similar Additional Tier 1 instruments that have been subject to a write-down;

(e) where an institution does not fulfil the combined capital requirements or restrictions as per CRD Article 131 apply, the maximum amount to be attributed to the write-up of the
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instrument shall be based on the higher of (i) the profit multiplied by the sum of the nominal of all Additional Tier 1 instruments before write-down that have been subject to a write-down divided by the total Tier 1 capital of the institution and (ii) the contractual interest amount of all Additional Tier 1 instruments subject to a write-down based on the reduced amount of the principal.

(f) the sum of any write-up amounts shall be treated as a payment that results in a reduction of Common Equity Tier 1 and shall be subject, together with other distributions on Common Equity Tier 1 instruments and payments on Additional Tier 1 instruments, to the restrictions relating to the Maximum Distributable Amount as laid down in Article 131 of the CRD, as transposed in national law or regulation.

(g) if the maximum amount determined in accordance with Section 20(3)(e) and complying with Section 20(3)(f) is not used for write-up of Additional Tier 1 instruments subject to a previous write-down or, in case the aggregate write-down amount is lower, not all Additional Tier 1 instruments have not been written up, either (i) the entire Maximum Distributable Amount as laid down in Article 131 of the CRD, as transposed in national law or regulation, has to be kept as retained earnings (i.e. no distributions should be made or (ii) distributions on temporarily written-down Additional Tier 1 instruments shall be payable on the reduced amount of the principal.

Article 21:
We agree in general with the provisions laid out in Article 21. However, with respect to Article 21a) it should be considered, what leads to a trigger event and to what extent this trigger event will be remedied immediately by measures already on the way and hence not requiring a write-down. In such a case, the institution shall liaise with the competent authority whether such write-down has to occur. The reason is that in such a situation already intended measures would cure the situation and a write-down could actually have a negative effect on the institution.

Regarding 21.f, it should be clarified, what an “independent review” looks like.

Article 22:
We agree with Article 22.

Example of a write up mechanism (ANNEX):
The operationalisation of the calculation model under indent 3(e) in combination with the Annex remains extremely difficult and thus lacks transparency. Hence, there are still considerable doubts over the feasibility of this approach.

The example in the ANNEX of the EBA RTS for a write-up mechanism according to Article 21.3 in our view needs further clarification:
- As a general remark, in our interpretation of the CRR and CRD IV the example does not properly reflect the regulations and directives mechanics for calculation of the MDA:
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- Pursuant to Article 131, the MDA depends on the position of the bank relative to its combined capital buffer requirements. According to CRD IV Article 123 and CRR 87, CET1 only contributes to the combined capital requirements to the extent that it is not required to meet the minimum requirements for Tier 1 and Total Capital not covered by AT1 and/or Tier 2. In case an institution operates with an “efficient capitalisation” such that it holds exactly 1.5% AT1, then any common equity created from a write-down of AT1 will be required to refill that AT1 to meet the Tier 1 minimum ratio.

- More important, the EBA example test the combined capital buffer at the start of each annual period, which unnecessarily penalises AT1 holders relative to the profit generated in that period. However, interim profits may lift an institution into a different quartile for MDA purposes. The calculation of the MDA factor as per CRD IV Article 131.4 b) would only apply for the portion of profits falling into the applicable combined capital buffer quartile. [E.g. interim profit might be sufficient to fill any residual amount to lift the institutions into the second quartile, hence any remaining profit contributing with a factor of 20% to the MDA. In case the profit is even high enough such that the 80% retention lifts the institution into the third profile, then any further residual profit would contribute even with a factor of 40% to the MDA. In the EBAs worked example, the institution has started from the first quartile, hence a factor of 0% would have been applied.]

We therefore ask for clarification that any write down or write up should only occur after the interim or year end profit has been reviewed according to Article 24.2.

9. Art. 24

We agree in general with the provisions laid out in Article 24 a).

While the instrument is issued via an SPV, the intention is foremost to issue a capital instrument for the operating entity, the holding or the group. As such, the institution wants to ensure that any obligations as well as ranking of the “inner” instrument with respect to the operating entity is passed on to the “outer” instrument issued by the SPV and held by third party investors. Therefore it should be possible that for example the issuer of the “inner” instrument to the SPV can provide the SPV with a (deeply) subordinate guarantee (in line with the actual instrument), enabling the SPV to fulfil its obligations under the instruments as if the instrument was issued by the institution directly. As such, this would not be considered as not complying with CRR Article 49.1 e).

10. Art. 25

Response to Q14:
Concerning Art. 25 (Indirect holdings arising from index holdings) we have the following questions: On paragraph 1: How should the term “index” be interpreted within the meaning of the CRR? Does this term only refer to official indices or should this also be understood in a broader sense designating each asset which may consist of several, different titles?
In lieu of a clarifying effect, the examples given in sentence 2 rather give rise to further questions. After all, especially indices of credit derivatives constitute rather exotic forms. We therefore suggest including
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the most obvious indices (mentioned in Art. 25 (5): equity index or bond index) in this sentence as clarification.
Moreover, we are of the opinion that "indices of credit derivatives" does not make much sense. It is hard to imagine to what this relates. CDS-indices may be common. However, it is hard to see how an investment in such indices (long position) should always be deducted from capital as an indirect or synthetic holding. We would expect that for instance a CDS that relates to bonds issued by a financial sector entity would not necessarily lead to an indirect/synthetic holding of instruments issued by that financial sector entity that has to be deducted from own funds - namely when such bonds do not qualify as Common Equity Tier 1, Additional Tier 1 or Tier 2 instruments.
Art. 25 (5): "Depending on the nature of the index (equity index or bond index)." This wording is probably confusing. Why / to what extent does the application depend on the nature of the index? One would assume that a corresponding deduction approach has to be applied in any case.
Therefore we suggest to either delete the first part of the sentence ("depending on the nature of the index (equity index or bond index)") or to start with the general principle and then add an explication on different types of indices ("The deduction shall be operated on a corresponding deduction approach. Depending on the nature of the index (equity index or bond index), the index may in invest in ...(provide examples).")

Treatment of different financial sector entities? A clarification would be welcome on what shall apply when the institution is unable to determine the maximum percentage for a number of relevant investments in a number of relevant financial sector entities (e.g. for instance five entities). It would obviously not make much sense to deduct the full amount of the index investment regarding each of those entities (which in our example would lead to a deduction of the overall index investment multiplied by five). Instead, it should be ensured that the amount of the index investment caps the overall deduction amount.

11. Art. 26

Response to Q15:
With regard to question 15 which is aimed at Article 26, we would first of all like to point out that this RTS is primarily aimed at the supervisor. The RTS ought to define when the competent supervisory authority may allow estimate solutions that are geared towards the fund’s investment principles because the more exact alternative approach would be deemed as "operationally burdensome". The proposals made in order to specify this rather vague legal concept in greater detail basically go into the right direction. However, in order to define in greater detail this unspecific legal concept, EBA again reverts to unspecific legal concepts without defining them, in turn, in a sufficiently detailed manner that would guarantee a uniform legal practice. For instance, the RTS provides no further specification as to when a "low materiality" within the meaning of indent 1 may be assumed. It remains equally open to interpretation when the net exposure shall be deemed "low" within the meaning of indent 2(a) and which order of magnitude is involved in a "holding period of short duration" or, moreover, "strong liquidity" within the meaning of indent 2(b). Particularly in view of the proportionality aspect ["relative to the institution's total own funds"] mentioned under indent 2(a) and so as to ensure a more consistent application of the law it would be possible indeed to mention more specific metrics. In this regard, we would like to refer to our proposals explained in greater detail under question 16.

A clarification on the alternative to a direct look-through in cases where the underlying exposures are unknown would be even more useful than for index securities (Art. 25 RTS), where the underlying
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investments are always more or less transparent. This can be different in case of investments in for instance intransparent (esp. non-UCITS) funds. The clarification could be added in the CRR. Moreover, such an alternative should not depend on additional requirements such as the "operationally burdensome"-concept of Art. 71 CRR / Art. 25 RTS. This is due to the fact that in case of intransparency, nobody is able to look through to the underlying exposure.

Response to Q16:
We strongly believe that an exemption amount should apply to the deduction of immaterial positions in cases where a look-through is simply not possible because the information required for steps 1) and 2) of the proposed approach is not available.

In such cases, we would suggest introducing an exemption amount of 3% of the institution’s total capital, meaning that the sum of all positions which the institution does not look through must not be higher than 3% of the institution’s total capital. A full deduction of an index holding should only be required if steps 1 and 2 of the EBA’s proposed approach are not feasible and the sum of all net long positions of the index holding exceeds 3% of the institution’s total capital.

We reject the proposed alternative structure-based approach as this will not simplify the process of determining the indirect holding in an index. Instead, we would like to suggest the following treatment of such index holdings to replace that currently outlined in paragraphs 3 and 4 of Article 25. Our proposed method makes a conservative estimate of the institution’s underlying exposure to the own funds instruments of relevant entities included in the indices:

1. The bank should be permitted to refrain from conducting a look-through to determine possible holdings if it can demonstrate that the fund does not or cannot contain any relevant holdings. A confirmation to this effect by the fund management company should suffice. Submission of up-to-date investment guidelines prohibiting investments in relevant holdings should also be deemed sufficient evidence.
2. If the bank cannot demonstrate in the manner described above that certain shares or units contain no relevant holdings, it should be permitted to carry out a risk-appropriate RWA calculation as part of its capital adequacy analysis instead of including the positions in the calculation of the 10 or 15% thresholds and possibly deducting them from own funds.
   a. An average risk weight for the entire fund should be determined which takes account of a 1,250% risk weight for the relevant holdings within the fund. This will ensure a conservative estimate of the positions in question since they will have to be backed in full with CET1. The investment management company or another (audited) third party should be permitted to determine this average risk weight. In Germany, risk weights of fund holdings are already calculated using a method of this kind and the procedure set out in Sections 36 (3) and 83 (5) of the German Solvency Regulation could serve as a model. The CRR also permits this procedure for calculating RWAs. Under Article 127(4) and Article 147(3) of the CRR, institutions may conduct a look through on the basis of the actual composition of a CIU and RWAs may be calculated by third parties.
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b. If this method cannot be used because the investment management company cannot supply the necessary data, the units should not be included in deductions but should be included in RWAs with a credit weighting of 370%. In our view, this credit weighting takes adequate account of the fact that the fund may contain positions requiring a 1,250% weighting. This procedure is also covered by Article 147(3) of the CRR, under which units are to be assigned a single risk weight.

12. Art. 27

However, the requirement that the earning power continues to be "sound" ought to be replaced by a requirement pursuant to which it should see no negative change. The current wording does not even provide banks lacking good earnings power with the possibility of buybacks. Yet, the financial crisis has shown that such buybacks can potentially be of benefit, too. At least, this holds true where buybacks will not have been previously replaced by at least equivalently liable capital.

In our view, CRR Article 73.3 a) focuses on situations e.g. where an institution likes to replace an existing capital instrument with lower distributions (e.g. coupons) by a new instrument with higher distributions that would lead to a higher interest expense or distribution going forward. Obviously, institutions will in such a case consider the overall economic and regulatory validity of such an “exchange”. In addition, where such an exchange leads to an improvement of the capital situation, which leads to the institution better fulfilling capital requirements, this should be welcomed by the competent authority. Further, we do not see the consideration of stress situations appropriate in that context. We therefore suggest deleting the last sentence of article 27.

13. Art. 28

The last sentence of paragraph 2 should be amended: “Sufficient certainty is deemed to exist in particular when a legal requirement for the institution exists to reduce or repurchase an own funds instrument.” To assume sufficient certainty would already exist at the time of public announcement of an intention to redeem would be far too early. The announcement of a buyback program and its maximum amount does not necessarily and not immediately mean that the capital will leave the institution.

14. Art. 29

Comment:
In paragraph 1, the word „early“ should be inserted: "The institution shall submit an application (...) before (...) calling, redeeming early or repurchasing Additional Tier 1 or Tier 2 instruments". Otherwise, any redemption of a dated Tier 2 instrument at its maturity would need the submission of an application.

Response to Q17:
In this context, the requirement under indent 3(a) appears to be rather onerous. After all, the 10% limit will see constant oscillations thus facing banks with considerable challenges in the calculation. Furthermore, this begs the question as to what is meant by "relevant issuance" in the context of CET 1, for instance if there is nothing else but shares. Should, in such a case, the 3% limit refer to the total
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share holdings? Hence, we suggest deleting the entire paragraph 3(a). This is particularly true in view of the fact that already today there are existing legal limits (5% in the trading book and 10% of the aggregate holdings).

Paragraph 3(b): Basically, the 10% or 3% ratio mentioned are not objectionable. They are in line with what has long since been an accepted practice.

Paragraph 4 should be deleted because it results in a national opt-in choice, which is something that should be ruled out, explicitly.

Under paragraph 5, the reference to paragraph 3 should be confined to paragraph 3(1). A limit on share buyback programmes for the purposes of share remuneration programmes should absolutely be avoided. Today, under (European) stock corporation legislation, there are already limits on buybacks within the framework of share remuneration programmes. Provisions and more stringent requirements which go beyond this are both unnecessary and counterproductive.

15. **Art. 30**

We generally agree that institutions should provide the competent authority with the rationale and the impact of an action listed in Article 72 CRR. However, the content and the depth of that information should be appropriate compared with the level of impact of such an action. E.g. to ask always for a 3 year capital plan might be disproportionate.

16. **Art. 31**

**Response to Q18:**
On the whole, the three month deadline mentioned in indent 1 appears to be very long. Under certain circumstances, also 1 month should be sufficient for a review. We should like to point out, that such long lead times inevitably compound the issue of rumour leakages with corresponding market repercussions. Whether or not the exemption clause envisaged under indent 3 creates sufficient flexibility in this regard seems to be at least questionable. We therefore suggest deleting the words “and under exceptional circumstances” under indent 3 thus allowing the competent authorities to shorten the lead time to less than 3 months at any point after having consulted the bank.

17. **Art. 32**

**Response to Q19:**
The 3% CET 1 threshold is generally acceptable. Whilst it means that from now on, contrary to the plans envisaged under circular 5/2011, only Common Equity Tier 1 Capital will serve as a baseline, this will, however, be acceptable if it is accompanied by a corresponding increase of the amount. On the other hand, the alternative calculation model envisaged under indent 2.2 appears to give cause for concern. Since this parameter is subject to constant change, the calculation version which focuses on the excess amount of Common Equity Tier 1 excessively complicates the entire approach. Due to the diverging focus
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of the two calculation models the corresponding approach leads to a situation where a considerable excess coverage of the CET 1 ratio becomes necessary for full utilisation of the 3% parameter - namely there has to be an aggregate excess coverage of 30% before the 3% can really be used. Otherwise, if there was a lower excess coverage ratio of the CET 1 requirements, the value which is respectively lower shall apply. In the final analysis, the calculation model is quite the opposite of a simplified approach thus eroding the rationale behind its initial inception. After all, the otherwise cumbersome and onerous approach of Article 29 and 30 is primarily intended for classical buyback programmes. The call facility inherent in the conception shares of cooperative societies should only trigger these consequences under exceptional circumstances.

Also in this respect, the calculation method which is obviously modelled on the approach concerning market making set out under Article 29 indent 3(a) appears to be unwarranted. After all, Article 32 does not focus on scenarios which – as would be the case in terms of market making – are beyond the bank’s own sphere of influence. In this regard, the clients call avoidance is an exogenous factor. Its materiality can indeed also be quantified using fixed metrics such as the 3% ratio. At this juncture, we strongly advocate in favour of deleting the alternative calculation method which is geared towards the CET 1 excess.

18. Art. 33

Response to Q20:
The limitation for the application of the waiver from deduction of own funds amounting to 5 years should be deleted. In most cases 5 years are not enough time to reorganise, restructure, integrate or to wind-up a medium sized or large bank.

We would like to point out that the presentations under indent 2 of the article is falsely presented as an interpretation of the term “temporary”. As a matter of fact, these presentations correctly belong into the context of the purpose of buying. After all, only newly acquired shares can serve the purposes of financial assistance. With regard to the presentations in Article 74(2) CRR, essentially, such presentations would also be covered by the mandate to the benefit of the EBA.

19. Art. 34

Response to Q21 and Q22
We do not agree with the limit on the amount of other assets of an SPE set at 0.5% (or lower) of the average total assets of the SPE over the last 3 years as we believe it to be too low. In general "other assets" of SPEs will only consist of assets that are necessary for operational business purposes or that are necessary to run the business. Especially smaller SPE structures might have difficulties staying within the limit of 0.5% for those assets.