EBA/CP/2013/17
23.05.2013

Consultation Paper

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

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)

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1. Responding to this Consultation

The EBA invites comments on all proposals put forward in this paper and in particular on the specific questions summarised in Part 4.3.

Comments are most helpful if they:

- respond to the question stated;
- indicate the specific point to which a comment relates;
- contain a clear rationale;
- provide evidence to support the views expressed/ rationale proposed; and
- describe any alternative regulatory choices the EBA should consider.

Please send your comments to the EBA by email to EBA-CP-2013-17@eba.europa.eu by 18.07.2013, indicating the reference 'EBA/CP/2012/17' on the subject field. Please note that comments submitted after the deadline, or sent to another e-mail address will not be processed.

Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. Please indicate clearly and prominently in your submission any part you do not wish to be publicly disclosed. A standard confidentiality statement in an e-mail message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with the EBA's rules on public access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the EBA's Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.eba.europa.eu under the heading 'Legal Notice'.

2. Executive Summary

The proposed Capital Requirements Directive (CRD) sets out requirements concerning own funds, which are expected to apply from 1 January 2014, and mandates the EBA to prepare draft regulatory technical standards (RTS) in this area.

The EBA has developed these RTS proposals on the basis of the legislative texts for the CRR agreed by the European Parliament and the Council in April 2013.[1] These texts will be subject to legal-linguistic review before being adopted formally and the final text being published in the Official Journal of the European Union. The EBA will review the RTS proposals to ensure that they take account of any changes made in the final text of the CRR, and any changes arising out of the consultation process.

This consultation paper puts forward draft RTS related to Articles 33(2), 69a(6) and 79(3) of the CRR related to deduction of indirect and synthetic holdings, to broad market indices and to minority interests.

In particular, the objectives of the draft RTS are the following:

- Regarding deduction of indirect and synthetic holdings: to achieve greater harmonisation as well as increased conservatism in the way the deductions of investments in financial sector entities as well as own capital instruments are applied;
- Regarding broad market indices: to put forward criteria for broad market indices so as to avoid that the interest rate/dividend paid by institutions on floating rate capital instruments increase when the credit standing of the institution decreases (credit sensitive dividend features);
- Regarding minority interest: to harmonise the calculation of minority interests to be included in regulatory capital.

The proposed RTS stem from additional mandates granted to the EBA in the final compromise of the Capital Requirements Regulation. Besides this consultation paper, the EBA also issued two consultation papers on certain RTS on own funds which were published on 4 April 2012[2] and 9 November 2012[3] as 'Part one' and 'Part two' of the consultation on Own Funds. The legal text proposed herein should be read in conjunction with the text of these consultation papers. The present consultation paper constitutes 'Part three' of the consultation. Further consultation papers on the remaining RTS on own funds in the CRR are expected to be published later in 2013.
These RTS will be part of the single rulebook aimed at enhancing regulatory harmonisation in Europe and namely at strengthening the quality of capital.

[1] The CRR text as agreed by the Council can be found at http://register.consilium.europa.eu/pdf/en/13/st07/st07747.en13.pdf
[2] http://eba.europa.eu/Publications/Consultation-Papers/All-consultations/2012/EBA-CP-2012-02.aspx
[3] http://eba.europa.eu/Publications/Consultation-Papers/All-consultations/2012/EBA-CP-2012-11.aspx

3. Background and rationale

Draft RTS on Own Funds - Part three

The so-called Omnibus Directive[4] amended the directives that are collectively known as Capital Requirements Directive (CRD)[5] in a number of ways, one of which was by establishing areas where the EBA is mandated to develop draft technical standards.

On July 20th 2011, the European Commission issued its legislative proposals on a revision of the CRD which aims to apply the Basel III framework in the EU. These proposals have recast the contents of the CRD into a revised CRD and a new CRR - which are colloquially referred to as the CRR/CRD IV proposals[6].

The proposed Capital Requirements Directive/Regulation (CRR/CRD) sets out requirements concerning own funds which are expected to apply from [1 January 2014] and mandates the EBA to prepare draft regulatory/implementing technical standards (RTS/ITS) in this area.

The EBA has developed these RTS proposals on the basis of the legislative texts for the CRR agreed by the European Parliament and the Council in April 2013,[7]in accordance with the mandate contained in Articles 33(2), 69a(6) and 79(3) of those texts.

The nature of RTS under EU law

The present draft RTS are produced in accordance with Article 10 of EBA regulation[8]. According to Article 10(4) of EBA regulation, RTS shall be adopted by means of a regulation or decision.

According to EU law, EU regulations are binding in their entirety and directly applicable in all Member States. This means that, on the date of their entry into force, they become part of the national law of the Member States and that their implementation into national law is not only unnecessary but also prohibited by EU law, except in so far as this is expressly required by them.

[4] Directive 2010/78/EU of the European Parliament and of the Council of 24 November 2010 amending Directives 98/26/EC, 2002/87/EC, 2003/6/EC, 2003/41/EC, 2003/71/EC, 2004/39/EC, 2004/109/EC, 2005/60/EC, 2006/48/EC, 2006/49/EC and 2009/65/EC in respect of the powers of the European Supervisory Authority (European Banking Authority), the European Supervisory Authority (European Insurance and Occupational Pensions Authority) and the European Supervisory Authority (European Securities and Markets Authority).

[5] Directive2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions and Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions.

[6] Proposal for a Regulation of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms, published on 20th July 2011.

[7] The CRD/CRR text as agreed by the Council can be found at
http://register.consilium.europa.eu/pdf/en/13/st07/st07746.en13.pdf
/http://register.consilium.europa.eu/pdf/en/13/st07/st07747.en13.pdf

[8] Regulation (EU) N° 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision N° 716/2009/EC and repealing Commission Decision 2009/78/EC.

Shaping these rules in the form of a Regulation would ensure a level-playing field by preventing diverging national requirements and would ease the cross-border provision of services; currently, an institution that wishes to take up operations in another Member State has to apply different sets of rules.

Background and regulatory approach followed in the draft RTS

The current applicable regulatory framework in terms of own funds is derived from the CRD, in particular Articles 56 to 67, as transposed by each Member State. The CRD was complemented by the publication of two sets of guidelines by the Committee of European Banking Supervisors (CEBS), the predecessor of the EBA. The first set of guidelines, published in December 2009, relates to hybrid capital instruments[9]. The second set of guidelines, published in June 2010, refers to elements of Article 57(a) of the CRD[10].

In December 2010, the Basel Committee on Banking Supervision (BCBS) published its 'global regulatory framework for more resilient banks and banking systems' aiming at addressing the lessons from the financial crisis. The CRR provisions related to own funds translate these BCBS proposals into EU law. Both reforms raise the issues of both the quality and the quantity of the regulatory capital base. The draft RTS as put forward by the EBA for this consultation are a direct result of the CRR provisions which will be applicable as of 1 January 2014.

This consultation paper constitutes Part three of the Own Funds consultation and puts forward draft RTS related to Articles 33(2), 69a(6) and 79(3) of the draft CRR whose provisions state that EBA shall develop draft RTS related to indirect and synthetic holdings, broad market indices and minority interests. The proposed draft RTS complement the draft RTS on own funds published on 4 April 2012 and 9 November 2012, in particular in terms of provisions related to deductions from Common Equity Tier 1.

All RTS related to own funds requirements are intended to be put forward as one integrated draft Regulation, as already announced in the EBA Consultation Paper on RTS for own Funds published on 4 April 2012 *[or final draft RTS]*. The rationale for this approach is to support the completion of the EU single rulebook for institutions in the area of own funds. It is useful to group these regulations together in one legal act to facilitate a comprehensive view, improve understanding and provide compact access to them by legal or natural persons subject to the obligations laid down therein. With that in mind, the draft RTS text proposed in the present document are an addition to the draft RTS text proposed in the above-mentioned CPs *[or final draft RTS]* and need to be read in conjunction with them. Various indications are given in the text in square brackets to clarify to the reader wherethe text proposed in this consultation fits with the texts of the previous consultations [or final draft RTS].
According to point 2 of Article 33 of the CRR, the EBA shall develop draft regulatory technical standards to specify the application of the deductions referred to in points (a), (c), (e), (f), (h), (i) and (l)

[9] http://www.eba.europa.eu/CMSPages/GetFile.aspx?nodeguid=97f3cd8f-855c-40de-a98b-b923e8eaa4ad
[10] http://www.eba.europa.eu/documents/Publications/Standards---Guidelines/2010/Guidelines_article57a/Guidelines_article57a.aspx

of paragraph 1 of that same Article; and related deductions contained in points (a), (c), (d) and (f) of Article 53 and points (a), (c) and (d) of Article 63. The EBA has already consulted on draft regulatory technical standards specifying the application of the deductions referred to in points (a), (c), (e) and (l), since this mandate was already included in the original proprosal from the EU Commission published in July 2011. The EBA is now consulting on the extended mandate.

First, the provisions included in these draft RTS explain what intermediate entities mean for the purpose of deducting holdings in financial sector entities held indirectly through intermediate entities (such as holdings in mutual funds, investment funds, pension funds etc which hold capital instruments of financial sector entities or special purpose entities). The draft provisions also elaborate on the different investments to be considered as synthetic holdings according to Article 22 (30a) of the CRR (such as investments in total return swaps, guarantees or credit protection or different types of options). The draft RTS also elaborate on the amount to be deducted from Common Equity Tier 1 items in each case.

The draft RTS also detail the calculation to be undertaken by institutions in order to determine the percentage held indirectly in a financial sector entity, meaning in situations where one or several intermediate entities stand between the institution and the financial sector entity. The draft RTS provide institutions with the methods to be used to calculate the final percentage of an indirect holding in a financial sector entity, taking into account situations where intermediate entities are serial or parallel intermediate entities (explanations of the two notions, of serial and parallel holding, as well as examples are provided in explanatory boxes for consultation purposes in the section that contains the draft RTS). The objective is to compare this final percentage with the percentage indicated in Article 40(a) of the CRR in order to determine whether the holding is below or above the threshold for significant investments in a financial sector entity.

Secondly, on the basis of the mandate included in point 6 of Article 69a of the CRR, the draft RTS focus on market indices used as references for the remuneration on Additional Tier 1 or Tier 2 instruments. In relation to this, the EBA is proposing several criteria that need to be fulfilled for indices to be considered as broad market indices. The EBA does not address in this draft RTS issues related to the governance of market indices, which are beyond its mandate and which will form part of other pieces of legislation currently under discussion in the EU. The draft RTS focus on correlation issues only, meaning that indices shall be sufficiently broad to ensure that the institution's own credit standing is not driving the rates set by that index. Two options are envisaged by the EBA in the draft RTS and input from market participants is sought in relation to these for the finalisation of the draft RTS.

Thirdly, the draft RTS elaborates on the calculation of minority interests as specified in Article 79(3) of the CRR. According to this Article, the EBA shall develop draft regulatory technical standards to specify the sub-consolidation calculation required in accordance with paragraph 2of Article 79, Articles 80 and 82. The EBA shall submit those draft regulatory technical standards to the Commission within one month of the date of entry into force of the CRR. For the purpose of these RTS, the EBA has developed several conditions to be met by institutions. An example illustrating the calculation of eligible minority interests at the level of the parent undertaking has been provided as an annex for consultation purposes.

4. Draft regulatory technical standards on Own Funds under Articles 33(2), 69a(6) and 79(3) of the draft Capital Requirements Regulation (CRR)

In between the text of the draft RTS that follows, further explanations on specific aspects of the proposed text are occasionally provided, which either offer examples or provide the rationale behind a provision, or set out specific questions for the consultation process. Where this is the case, this explanatory text appears in a framed text box.

EUROPEAN COMMISSION

Brussels, XXX
[…](2012) XXX draft

COMMISSION DELEGATED REGULATION (EU) No …/..

of XXX

[…]

COMMISSION DELEGATED REGULATION (EU) No …/2012

of XX month 2012

supplementing Regulation xx/XX/EU of the European Parliament and of the Council [CRR number] with regard to regulatory technical standards for Own Funds

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Regulation [xx/XX/EU] of the European Parliament and of the Council of [dd mmmm yyyy] on prudential requirements for credit institutions and investment institutions[11] [the CRR], and in particular to Articles... 33(2), 69a(6) 79(3)[TO BE ADDED TO THE ARTICLES MENTIONED IN EBA/CP/2012/02AND EBA/CP/2012/11] thereof,

Whereas:

….

(6) In order to avoid regulatory arbitrage and ensure a harmonised application of the capital requirements rules in the EU, it is important to ensure that there is a uniform approach concerning the deduction from own funds of certain items like losses for the current financial year, *indirect and synthetic holdings in own own funds instruments and indirect and synthetic holdings in other financial sector entities*, deferred tax assets that rely on future profitability, and defined benefit pension fund assets. [TEXT IN ITALICS TO BE ADDED TO RECITAL 6 AS PRESENTED IN EBA/CP/2012/02]

(6a) Given that Regulation xx/xxx [CRR] already provides rules for direct holdings of own own funds instruments and in other financial sector entities, this Regulation should establish rules for the deduction from own funds of holdings that relate to indirect and synthetic holdings of such instruments or in other financial sector entities.

(6b) The treatment of indirect holdings arising from index holdings is covered by Article xx of Regulation xx/xxx [CRR] and by Articles 25 and 26 of this Regulation *[meaning articles 25 and 26 of the draft RTS on own funds – part one]*. Therefore, Article 14a of this Regulation should only cover indirect and synthetic holdings under Article 33(1), (f), (h), (i), Article 53(a), (c), (d), (f) and Article 63(a), (c), (d) of Regulation xx/XX/EU [CRR].

Where an institution's own credit standing drives the rates set by market indices which are also used as a reference for the remuneration of Additional Tier 1 and Tier 2 instruments of the institution, prudential concerns related to the correlation between the distributions on the instrument and the credit standing of the institution arise. The number and the diversity of institutions in the panel should be high enough to adequately reflect the activities in the related market.Therefore, if an institution issues an Additional Tier 1 or Tier 2 instrument with a floating rate or a fixed rate that will revert to a floating rate, the rate that it pays on that instrument should not increase when the firm's credit standing declines. Hence the requirement, where the rate is linked to an index, that the index should be sufficiently 'broad'

[11] OJ…….

to ensure that the institution's credit standing is not driving the rates set by that index.The distinction here is between correlation due to the entire sector suffering stress and affecting the benchmark rate, and correlation due to one institution's credit standing affecting the benchmark rate.Therefore, the only indices that should qualify as broad indices for the purposes of Article 69a(1) should be those market indices which ensure that an institution's own credit standing is not driving the rates set by these market indices. [RECITAL TO BE ADDED AFTER RECITAL No 8 AS PRESENTED IN EBA/CP/2012/02].

(11a) The eligible minority interests of a subsidiary that is a parent undertaking of a financial sector entity should be the amount that results, for the parent institution of that subsidiary, when the parent institution applies the prudential consolidation referred to in Part One Title Two of Regulation xx/XX/EU [CRR] [to be completed after the consultation] .

(11b) Given the similar nature of the deductions covered by Articles 79, 80 and 82 of Regulation xx/xxx [CRR], the same provisions for the calculation of eligible minority interests should apply to all of these cases.

….

TITLE II

Elements of own funds

Chapter 1
Common Equity Tier 1 capital

.....

Section 3
Deductions from Common Equity Tier 1 items

.....

Sub-section x Deductions of direct, indirect and synthetic holdings under Article 33(1) (f) (h),(i), Article 53(a), (c), (d) (f) and Article 63(a), (c), (d) of Regulation xx/xx[CRR]

(Legal basis: Article 33(2) of Regulation xx/xx[CRR])
[ARTICLES TO BE ADDED AFTER ARTICLE 14 OF THE TEXT AS PROPOSED IN EBA/CP/2012/02]

Explanatory text for consultation purposes

According to point 2 of Article 33 of the CRR, EBA shall develop draft regulatory technical standards to specify the application of the deductions referred to in points (a), (c), (e), (f),(h), (i) and (l) of paragraph 1 of this Articleand related deductions contained in points (a), (c), (d) and (f) of Article 53 and points (a), (c) and (d) of Article 63. The EBA has already consulted on draft regulatory technical standards specifying the application of the deductions referred to in points (a), (c), (e) and (l) of Article 33, since this mandate was already included in the original proprosal from the EU Commission published in July 2011. The EBA is now consulting on the extended mandate that relates to points (f), (h) and (i) of Article 33 as well as points (a), (c), (d) of Article 53 and points (a), (c), (d) of Article 63.

Paragraph 1 of this Article 14a explains what intermediate entities mean for the purpose of deducting holdings in financial sector entities held indirectly through intermediate entities.
This paragraph contains provisions relating to pension funds in particular. These provisions have to be read in conjunction with the deductions referred to in Article 33(e) of the CRR. Institutions are invited to provide input regarding cases where there may be an overlap between the two types of deductions (see Q02).

Paragraph 2 of this Article 14a provides different forms of investments to be considered as synthetic holdings according to Article 22 (30a) of the CRR. The approach taken by the EBA is conservative as the deductions required are for the notional amount and from the date of signature of the contract between the institution and its counterparty.

It is worth underlining that the treatment of own capital instruments under this proposed draft RTS should always be deduction (by reference to Article 33) and not derecognition, asinstruments are held by the issuing institution itself whereas in the case of direct or indirect funding, which would be a case for derecognition, they are held by a third party. Also, the requirements of the CRR in relation to short positions that may be netted against gross long positions in particular counterparty risk or maturity restrictions do apply in full.

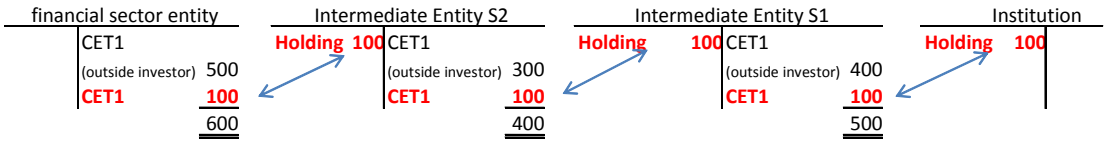
Articles 14b to 14f refer to the calculation of the amount to be deducted from own funds depending on the type of holding (holdings in intermediate entities, synthetic holdings). These articles refer in particular to the calculation of the relevant amount and percentage of a holding that is held indirectly, under points (f), (h) and (i) of Article 33(1) of the draft CRR, depending on whether the institution has a significant investment in financial sector entities or not.

The illustrations below, which must be read from right to left, show the calculation of the relevant amount for one financial sector entity, held indirectly by an institution. Using two distinct approaches (serial and parallel) the illustration below explains the text of these Articles 14c and 14f .The objective is to calculate in each case the final amount held by the institution in the financial sector entity, taking into account the existence of intermediate entities standing between the institution and the financial sector entity. This final amount will then have to be used for the related deduction and to assess if the total holding (direct, indirect and synthetic) exceeds the threshold indicated in Article 40(a) of the CRR relating to significant investments in a financial sector entity.

In these stylistic examples, the intermediate entities are funded only by shares (or CET 1 instruments). In practice, the institution may have an exposure in another form than shares, for example in the form of senior or subordinated bonds or loans. These exposures shall also be taken into account for the calculation when the loss that the institution would incur on these exposures, as a result of a permanent write off of the CET1 instruments issued by the financial sector entity, would not be materially different from the lossthe institution would incur from a direct holding of those CET1 instruments issued by the financial sector entity. In case the exposures of all investors in the intermediate entity do not rank pari passu, the institution shall take into account the ranking between funding types for the purpose of the calculation of the amount to be deducted. This methodology is consistent with the EBA draft regulatory technical standards related to Article 379 of the CRR.

Serial holdings. As per the graph below, where an institution indirectly holds capital instruments in the financial sector entity through intermediate entities in a serial fashion and where no additional intermediate entities exist between the institution and the financial sector entity, the relevant factors are i) the amount of CET1 instruments held by the institution in

intermediate entity S1 divided by the total amount of CET1 instruments issued by that intermediate entity (100/500), ii) the amount of CET1 instruments held by intermediate entity S1 in intermediate entity S2 divided by the total amount of CET1 instruments issued by that intermediate entity (100/400), and iii) the amount held by intermediate entity S2 (100) . This leads to the following calculation:
(100/500) * (100/400) * (100) = 5



Thus, the relevant factor i) is dividedby ii):

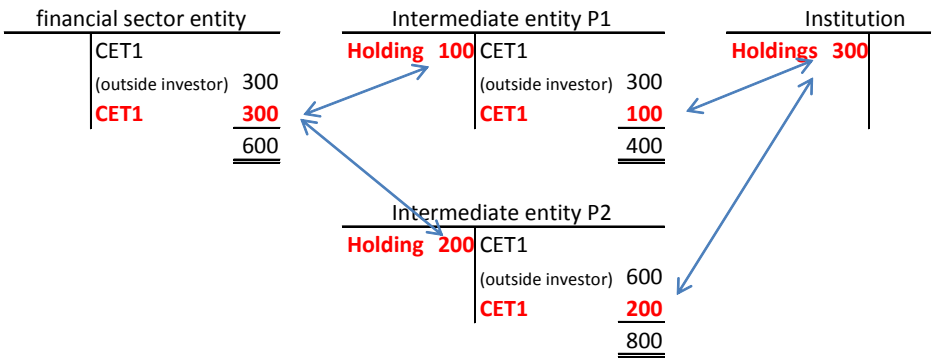
i) mathematical product of all numerators in a row: 100 * 100 * 100 = 1,000,000
ii) mathematical product of all denominators in a row: 500 * 400 = 200,000.

For the assessment against the relevant percentage of Article 40(a), the resulting amount of 5 shall be added to the amount of direct other indirect and synthetic holdings in the financial sector entity and divided by the total amount of CET1 issued by the financial sector entity (600). In this example the percentage of holding will be 0.83% (5/600) and, in the absence of direct other indirect and synthetic holdings, the indirect holding does not qualify as a significant participation pursuant Article 40(a).

Note that the term 'mathematical product' is used to denote the result of the multiplications above.

Consequently the draft RTS mentions in paragraph 2 of this Article 14c:
'(a) the result of the multiplication of amounts of fundingprovided by the institution in intermediate entities, by these intermediate entities in subsequent intermediate entities, and by these subsequent intermediate entities in the financial sector entity.
(b) the result of the multiplicationof amounts of Common Equity Tier 1 instruments issued by each intermediate entity'.

Parallel holdings. Following the graph below, the intermediate entities are held in parallel.



For parallel holdings one should sum the outcomes of the calculations fromthe serial approach above over each intermediate entity held in parallel. This results in the amount of 25 for intermediate entity P1, and 50for intermediate entity P2. Summed over each holding (25 + 50)

the resulting amount to be taken into account for the deduction relating to the financial sector entity is 75 :

P1: 100/400 * 100 = 10,000 / 400 =**25**
P2: 200/800 * 200 = 40,000 / 800 = **50**
---------- +
Total: **75**
==========
Consequently, the institution has an indirect holding of 75 in the financial sector entity and thus a share of 12.5 % (75/600) of the CET1 of this financial entity.The holding is significant according to Article 40 (a) of the CRR: 12.5%>10%.

The calculation above shall be performed for each financial sector entity indirectly held because of the obligation to assess whether the threshold of Article 40(a) is exceeded.

Where, on the basis of the total amount of gross long positions,the threshold of Article 40(a) is exceeded, the amount of indirect and synthetic holding resulting from the calculation referred to in Articles 14c and 14e shall be deducted from Common Equity Tier 1 on the basis of point (i) of Article 33 of the CRR. Where the threshold is not exceeded, the deduction will be made on basis of point (h) of Article 33 of the CRR. The amount to be deducted shall take into account short positions and positions through indices in the financial sector entity as defined in Article 42 of the CRR.

Where an institution chooses not to perform the above-mentioned calculation, in cases where, for example, it would be too burdensome, the institution may as an alternative adopt a structure-based approach according to Article 14d, using in particular the investment mandates of the intermediate entities. In such a case, the institution shall consider the holdings of capital instruments of financial sector entities as significant investments and take into account the amount of the investment in the intermediate entities as the amount to be deducted. Such an alternative approach is not available in cases where the institution exercises control or a significant influence on the intermediate entities as the institution is deemed to have sufficient information to perform a look-through approach.

In this approach, the institution shall make a distinction between own CET1 instruments that the intermediate entity holds, or the maximum amount the intermediate entity may hold taking into account the investment mandate, and holdings in other financial intermediate entities, in order to apply point (f) of article 33(1) of the CRR.

If the institution is not able to identify, on the basis of this structured approach, the maximum amount that the intermediate entity may hold in own CET1 instruments and in CET1 instruments issued by other financial sector entities, the assumption shall be made that the intermediate entity may be fully invested in own CET1 instruments and the deduction is made on basis of point (f) of Article 33(1).

The treatment proposed in this RTS does not apply where intermediate entities are institutions or entities that are subject by virtue of applicable national law to the requirements of the CRR and the CRD since they are already covered by the CRR provisions related to deductions from Common Equity Tier 1 items.

Provisions included in this Article 14i of the proposed draft RTS follow from limitations in the applicable accounting framework. Most accounting frameworks do not enable separate identification of intangible assets included in holdings that are not significant.

Questions

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

Q02: Provisions included in paragraph 1of 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 mightbe an overlap between the two types of deductions? Please describe precisely these situations and the nature of the problem.

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?

Q04: Do you agree with the examples of synthetic holdings provided in paragraph2 of the following Article 14a? Should other examples be added to this list?

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?

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?

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

Article 14a-
Indirect and synthetic holdings for the purposes of Article 33(1) (f),(h) and (i) of Regulation xx/xxx [CRR]

1. Indirect holdings of capital instruments pursuant to Article 33(1) (f) (h) and (i) of Regulation xx/XX/EU [CRR], shall include but are not limited to, any exposure, including senior exposures, to an intermediate entity that has an exposure to Common Equity Tier 1 instruments issued by a financial sector entity where, in the event the Common Equity Tier 1 instruments issued by the financial sector entity were permanently written off, the loss that the institution would incur as a result would not be materially different from the loss the institution would incur from a direct holding of those Common Equity Tier 1instruments issued by the financial

sector entity. Intermediate entities shall be entities other than institutions in the meaning of article 4(4) of Regulation xx/XX/EU [CRR]and shall include:

(a) Mutual funds, investment funds, pension funds, index funds or securitisation special purpose entities that hold capital instruments of financial sector entities;
(b) Defined benefit pension funds that hold capital instruments of financial sector entities, where the institution is supporting the investment risk;
(c) Entities, that hold capital instruments of financial sector entities,when they are not included in the same scope of prudential consolidation as the institution and for which one of the following conditions apply:

(i) these entitiesare directly or indirectly under the control or under significant influence of one of the following:

(a) the institution or its subsidiaries;
(b) the parent undertaking of the institution or the subsidiaries of that parent undertaking;
(c) the parent financial holding company of the institution or the subsidiaries of that parent financial holding company;
(d) the parent mixed activity holding company of the institution or the subsidiaries of the parent mixed activity holding company;
(e) the parent mixed financial holding company or the subsidiaries of the parent mixed financial holding company;
(f) any institution or any entity that falls within the same institutional protection scheme referred to in Article 108(7) of Regulation xx/xxx [CRR] or that is part of the same network of institutions affiliated to a central body that are not organized as a group;

(ii) these entities are special purpose entities or entities other than institutions or entities that are subject by virtue of applicable national law to requirements of Regulation xx/XX/EU [CRR] and Directive [CRDIV] whose activity is to hold financial instruments issued by financial sector entities.

2. Synthetic holdings shall include, but are not limited to the following forms:

(a) investments in total return swaps on a capital instrument of a financial sector entity,

(b) guarantees or credit protection provided to a third party in respect of the third party's investments in a capital instrument of a financial sector entity,

(c) call options purchased by the institution on a capital instrument of a financial sector entity,

(d) put options sold by the institution on a capital instrument of a financial sector entity or any other actual or contingent contractual obligation of the institution to purchase its own capital instruments,

(e) investments in forward purchase agreements on a capital instrument of a financial sector entity.

Article 14b-
Calculation of indirect holdings for the purposes of Article 33(1) (f),(h) and (i) of Regulation xx/xxx [CRR]

The amount of indirect holdings held through intermediate entities to be deducted from Common Equity Tier 1 items referred to in points (f), (h) and (i) of Article 33 (1) of Regulation xx/XX/EU [CRR] shall be calculated in one of the following ways:

(a) according to the default approach of Article 14c;
(b) where the method described in Article 14c is deemed to be operationally burdensome, using the structure-based approach described in Article 14d. This structure-based approach shall nevertheless not be used by institutions for estimating these deductions in relation to investments in intermediate entities referred to in Article 14a (c)(i).

Article 14c-
Default approach for the calculation of indirect holdings for the purposes of Article 33(1) (f),(h) and (i) of Regulation xx/xxx [CRR]

1. Under the default approach, for indirect holdings held through intermediate entities referred to in Article 14 a, the amount deducted from Common Equity Tier 1 items referred to in points (f), (h) and (i) of Article 33(1) of Regulation xx/XX/EU [CRR] shall equal:

    a) if the exposures of all investors in this intermediate entity rank pari passu, as the percentage of funding multiplied by the amount of Common Equity Tier 1 instruments held by the intermediate entity in the financial sector entity or;
    b) if the exposures of all investors in these entities do not rank pari passu, as the percentage of funding multiplied with the lower of :
        i. the amount of Common Equity Tier 1 instruments held by the intermediate entity in the financial sector entity or

ii. the institution's exposure to the intermediate entity together with all other funding provided to this intermediate entity that rank pari passu with the institution's exposure.

This calculation is made for each tranche of funding that rank pari passu with the funding provided by the institution.

The percentage of funding is the institution's exposure divided by the sum of the institution's exposure to the intermediate entity and all other funding provided to this intermediate entity that rank pari passu with the institution's exposure.

This amount shall be calculated separately for each holding in a financial sector entity held by intermediate entities.

The amount to be deducted from Own funds shall not be higher than the total funding provided by the institution to the intermediate entity and the amount of Common equity Tier 1 instruments held by the intermediate entity in financial sector entity

2. In cases where investments in Common Equity Tier 1 instruments of a financial sector entity are held indirectly through subsequentor several intermediate entities, the percentage of funding in paragraph 1 shall be determined by dividing the factor referred to in point (a) below by the factor referred to in point (b) below :

(a) the result of the multiplication of amounts of funding provided by the institution in intermediate entities, by these intermediate entities in subsequent intermediate entities, and by these subsequent intermediate entities in the financial sector entity.

(b) the result of the multiplication of amounts of capital instruments or other instruments as relevant, issued by each intermediate entity

This amount shall be calculated separately for each holding in a financial sector entity held by intermediate entities and for each tranche of funding that rank pari passu with the funding provided by the institution and the subsequent intermediate entities.

Article 14d-

Structure-based approach for the calculation of indirect holdings for the purposes of Article 33(1) (f),(h) and (i) of Regulation xx/xxx [CRR]

1. Under the structure-based approach, an institution shall take into account separately the amount that the intermediate entity holds in Common Equity Tier 1 instruments

of the institution and the amount that the intermediate entity holds in Common Equity Tier 1 instruments of other financial sector entities on an aggregate basis.

2. The amount to be deducted from Common Equity Tier 1 items referred to in point (f) of Article 33 (1) of Regulation xx/XX/EU [CRR] equals the percentage of funding, as defined in article 14 (c), held in the intermediate entity multiplied by the amount of Common Equity Tier 1 instruments held by the intermediate entity in the institution.

3. The amount to be deducted from Common Equity Tier 1 items referred to in points (h) and (i) of Article 33 (1) of Regulation xx/XX/EU [CRR] shall equal the percentage of funding, as defined in article 14 (c), held by the institution in the intermediate entity multiplied by the aggregate amount of Common Equity Tier 1 instruments held by the intermediate entity in financial sector entities.

4. The institution shall consider the amount relating to holdings in Common Equity Tier 1 instruments of those financial entities as a significant investment referred to in Article 40 of Regulation xx/XX/EU [CRR] and deduct the amount in accordance with point (i) of Article 33 (1) of the Regulation xx/XX/EU [CRR].

5. Where investments in Common Equity Tier 1 instruments are held indirectly through subsequent or several intermediate entities, the provisions of Article 14 c (2) apply.

6. When the institution is not able to identify the aggregate amounts that the intermediate entity holds in Common Equity Tier 1 instruments of the institution or in Common Equity Tier 1 instruments of other financial sector entities, institutions shall estimate those amounts by using the maximum amounts that the intermediate entities are able to hold on the basis of their investment mandates.

7. When the institution is not able to determine, on basis of the investment mandate, the maximum amount that the intermediate entity holds in Common Equity Tier 1 instruments of the institution or in Common Equity Tier 1 instruments of other financial sector entities, the institution shall treat the amounts of funding, in the form of capital instruments or other instruments, including senior funding, as relevant, that it holds in the intermediate entity as an investment in its own Common Equity Tier 1 instruments and deduct them in accordance with Article 33(1) (f) of Regulation xx/XX/EU [CRR].

Article 14e-
Calculation of synthetic holdings for the purposes of Article 33(1) (f),(h) and (i) of Regulation xx/xxx [CRR]

1. Regarding synthetic holdings referred to in paragraph 2 of Article 14a, the amount to be deducted from Common Equity Tier 1 items referred to in points (f), (h) and (i) of Article 33(1) of the Regulation xx/XX/EU [CRR]shall be the notional amount of the relevant instruments.
2. The deduction shall take place from the date of signature of the contract between the institution and the counterparty.

Article 14f-
Assessment of the threshold of Article 40(a) for the purposes of Article 33(1)(h) and (i) of Regulation xx/xxx [CRR]

1. 1. In order to assess whether an institution owns more than 10% of the Common Equity Tier 1 instruments issued by a financial sector entity, according to Article 40 (a) of Regulation xx/XX/EU [CRR], institutions shall sum the amounts of their gross long direct, indirect and synthetic holdings of Common Equity Tier 1 instruments of this financial sector entity following the calculation referred to in Articles 14b and 14 d and compare this sum to the amount of Common Equity Tier 1 capital issued by the financial sector entity.
2. The assessment described in this paragraph shall be made for each financial sector entity in which investments in Common Equity Tier 1 capital instruments are directly, indirectly or synthetically held.

Article 14g-
Holdings of Additional Tier 1 and Tier 2

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), 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 than the total funding provided by the institution to the intermediate entity, other holdings of CET1 shall be considered for the deduction. Similarly, in case the intermediate entity holds Common Equity Tier 1 instruments, Additional Tier 1 instruments and Tier 2 instruments of financial sector entities, 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.

Article 14h-
Maturity of long positions

Where the institution has a long position in a form of a capital instrument and has a contractual right or obligation to sell a long position at a specific point in time and the counterparty in the contract has an obligation to purchase the long position if the institution exercises its right to sell, this point in time may be treated as the maturity of the long position for the purpose of Article 42(a) of Regulation xx/XX/EU [CRR].

Article 14i-

Goodwill

For the application of deductions referred to in Article 33(1)(h) of Regulation xx/XX/EU [CRR], institutions are not required to identify goodwill separately when determining the applicable amount to be deducted according to provisions of Article 43 of Regulation xx/XX/EU [CRR].

TITLE II

Elements of own funds

Chapter xx
Own funds

Article 24b
Distribution on own funds instruments – broad market indices

(Legal basis: Article 69a(6) of the CRR)

Explanatory text for consultation purposes
According to point 6 of Article 69a of the CRR, the EBA shall develop draft regulatorytechnical standards to specifythe indices that shall be deemed to qualify as broad indices for the purposes of paragraph 1 of this Article. The 'broad market index' reference in Article 69a implements the Basel FAQ12 that deals with the issue of credit-sensitive dividend features. The objective here is that, if an institution issues an AT1 or Tier 2 instrument with a floating rate or a fixed rate that will revert to a floating rate, the rate that it pays on that instrument should not increase when the institution's credit standing declines. Thus, where it is linked to an index, that index should be sufficiently 'broad' to ensure that the institution's credit standing is not driving the rates set by that index.

[12] Basel FAQ 12 on Paragraphs 54-56 (Criteria for Additional Tier 1 capital). See http://www.bis.org/publ/bcbs211.htm?ql=1.

The distinction here is between correlation due to the entire sector suffering stress and affecting the benchmark rate, and correlation due to one institution's credit standing affecting the benchmark rate. In other words, the intended meaning of 'broad' is that the benchmark rate is not materially affected by the credit standing of an individual participating institution.

In this draft RTS, the EBA does not address issues related to the governance of market indices, which is beyond the scope of its empowerment and which will be part of other pieces of legislation currently under discussion. The draft RTS are meant to focus only on correlation issues.

Issues encountered by the EBA when drafting these draft RTS relate to the number of contributors included in the panel, since this number of contributors may be quite low in some jurisdictions using local market indices. The EBA would like to receive feedback from respondents to this consultation on the two options being considered: one related to a minimum number of contributors (in relation to which feedback on the appropriate minimum number would also be welcome); and another one related to a minimum representativeness of the market in addition to a lower minimum number of contributors (in relation to which feedback on how to ensure this representativeness, which methodology to be used and which percentage to be chosen would also be welcome).
For the purpose of the second option, a definition of Monetary financial institutions similar to the one provided by the ECB regulation was used.

Questions for consultation:

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

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?

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?

An index shall be deemed to be a broad market index if it meets all of the following criteria:

(a) it is used to set interbank lending rates in one or more currencies;

(b) it is used as a reference rate for floating rate debt issued by the institution in the same currency, where applicable;

(c) it is calculated as an average rate by a body independent of the institutions that are contributing to the index;

(d) each of the rates set under the index are based on quotes submitted by a panel of institutions active in that interbank market;

(e) the panel shall include at least [6] different contributors before any discount of quotes for the purposes of setting the rate;

(f) where to the provisions of subparagraph (d) do not apply, the composition of the panel ensures a sufficient level of representativeness of institutions present in the Member State. A sufficient level of representativeness is deemed to be achieved where both of the following conditions are met:

i) the panel includes at least [4] different contributors before any discount of quotes for the purposes of setting the rate, and

ii) the contributors to the panel represent at least [60%] of the related market. The related market shall be definedas the sum of assets and liabilities of the effective contributors to the panel in the domestic currency divided by the sum of assets and liabilities in the domestic currency of monetary financial institutions. Monetary financial institutions (MFIs) shall be defined as resident credit institutions, and other resident financial institutions whose business is to receive deposits and/or close substitutes for deposits from entities other than MFIs, and, for their own account, at least in economic terms, to grant credits and/or make investments in securities.

Article 34b
Minority interests included in consolidated Common Equity Tier 1 capital

(Legal basis: Article 79(3) of the CRR)

Explanatory text for consultation purposes

According to Article 79(3) of the CRR, EBA shall develop draft regulatory technical standards to specify the sub-consolidation calculation required in accordance with paragraph 2of this Article, Article 80 and 82.

For the purpose of this RTS, an institution shall determine the amount of minority interests of a subsidiary that is included in consolidated Common Equity Tier 1 capital-CET1 (‘the eligible minority interest’) by deducting the amount of the excess capital of the subsidiary that is attributable to minority interests from the amount of the minority interests of the subsidiary.

The following conditions shall apply:

- The institution is the institution for which the eligible minority interest of a certain subsidiary is calculated.

- Minority interest means the amount of Common Equity Tier 1 capital of the subsidiary that is attributable to parties other than those included in the prudential scope of consolidation of the institution. The minority interest of the subsidiary is calculated as the amount that arises to the institution when the institution applies the prudential consolidation referred to in Part One Title Two of the CRR.
- Excess capital of the subsidiary is the amount of CET1 capital as defined in Article 47 of the CRR including the eligible minority interests that arise from its own subsidiaries that exceed the CET1own fundsrequirements of the subsidiary as defined by Article 79 of the CRR.
- The CET1 own funds requirements of the subsidiary for the purpose of Article 79 is the lower of the own funds requirements between those required by Article 79(1)(a)(i) and those required by Article 79(1)(a)(ii) of the CRR.
- The attribution of this excess capital to the minority interests of the subsidiary is determined by multiplying the factor referred to in point (a) by the factor referred to in point (b):

(a) eligible minority interests as defined above
(b) the amount of minority interests of the subsidiary divided by the total amount of CET1 instruments of the subsidiary, plus the related share premium accounts, retained earnings and other reserves.

The principles set out in the following article, developed for the application of Article 79 of the CRR, apply by analogy to Article 80 and 82 of the CRR. An illustrative example has been annexed to this consultation paper.

In accordance with Article 79(2), the calculation of eligible minority interest shall be undertaken on sub-consolidated basis for each subsidiary. This may be an issue when the subsidiary is not subject to supervision on sub-consolidated basis, but only on individual basis, in application of Part One Title Two of the CRR, notably because the subsidiary does not fall under the application of the Article 20 of the CRR. The current draft RTS does not specify the calculation to be undertaken in that case. The EBA wishes to investigate this issue further.

In the same vein, the current RTS does not specify how to calculate eligible minority interests arising from an institution permitted under Article 8 of the CRR to incorporate a subsidiary in the calculation of its solo requirements.

EBA makes use of the opportunity offered by the consultation to collect industry's view on the two questions formulated below.

Questions for consultation:

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)?

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 a supervision on a sub-consolidated basis.What would you propose as conditions?

1. For the purpose of specifying the sub-consolidation calculation required in accordance with paragraph 2 of Article 79 and Articles 80 and 82 of Regulation xx/XX/EU [CRR], the eligible minority interests of a subsidiary that is itself a parent undertaking of at least a financial sector entity shall be calculated in the described in paragraphs 2 to 3.

2. Where the subsidiary complies with the provisions of Part Three of Regulation xx/XX/EU [CRR] on the basis of its consolidatedsituation:

    (a) the Common Equity Tier 1 capital of that subsidiary on its consolidated basis referred to in Article 79(1)(a) of Regulation xx/XX/EU [CRR] shall include the eligible minority interests that arise from its own subsidiaries calculated pursuant to the provisions of Article 79 and the provisions laid down in this Regulation [draft RTS on own funds Part Three], notably points (b) and (c) below;
    (b) for the purpose of the sub-consolidation calculation the amount of Common Equity Tier 1 capital required according to Article 79(1)(a)(i) of Regulation xx/XX/EU [CRR], shall be the amount required to meet the Common Equity Tier 1 own funds requirements of that subsidiary at the level of its consolidated situation calculated in accordance with Article 79(1)(a) of Regulation xx/XX/EU [CRR]. The specific own funds requirements referred to in Article 100 of Directive [inserted by OP] are the one set by the competent authority of the subsidiary;
    (c) the amount of consolidated Common Equity Tier 1 capital required, according to Article 79(1)(a)(ii) of Regulation xx/XX/EU [CRR],shall be the contribution of the subsidiary on the basis of its consolidated situation to the Common Equity Tier 1own funds requirements of the institution for which the eligible minority interests are calculated on a consolidated basis. For the purpose of calculating the contribution, all intra-group transactions between undertakings included in the prudential scope of consolidation of the institution shall be eliminated.

3. In order to perform the consolidation referred to in paragraph 2(c), the subsidiary shall only take into account undertakings that are included in the prudential scope of consolidation of the institution for which the eligible minority interests are calculated.

4. Where the waiver described in Article 79(2a) of Regulation xx/XX/EU [CRR] applies to a subsidiary, any parent undertaking of the subsidiary benefiting from the waiver may include in its Common Equity Tier 1 capital minority interests arising from subsidiaries of the subsidiary benefiting from the waiver, provided that the calculations foreseen in Article 79(1) of Regulation xx/XX/EU [CRR]and in this Regulation have been made for each of those subsidiaries.

5. The methodology followed in paragraphs 1 to 4 shall also followed to calculate the amount of qualifying Tier 1 instruments under Article 80 of the CRR and the amount of qualifying own funds under Article 82 of Regulation xx/XX/EU [CRR].

ANNEX 1- EXAMPLE ON MINORITY INTERESTS....

See following pages

Example on the calculation of minority interests

Assumptions:

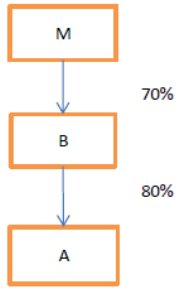
Capital requirements level		Assets' RW	
A (Bank)	9%	credits	100%
B (Bank)	8%	shares	250%
M	8.5%		

Other assumptions:

Intangibles imply full deduction to CET1

No Intra-group exposures

Group Structure



Balance sheets (BS) of the several entities in the example:

A solo

Assets of A	450	Capital	**100**
		Debt	350
	450		450

B solo

Shares in A	80	Capital	**50**
Assets of B	90	Debt	120
	170		170

M solo

Shares in B	35	Capital	**185**
Intangibles	150	Debt	0
	185		185

Chapter 1 - Calculation of the CET1 of B

In the language of article 79:

B is considered as the "Institution"

A is considered as the "subsidiary"

A on a subconsolidated basis is, in fact, its solo basis as A does not have any other subsidiary of its own that is consolidated at the level of B.

B subconsolidated BS is considered as the consolidated balance sheet

Section 1 - In order to calculate the Eligible MI from the shareholder capital of A to the CET1 ratio of B, we have:

Step 1 - Perform the A's subconsolidated BS

A subconso (in this example, the same as the solo)

Assets of A	450	Capital	**100**
		Debt	350
	450		450

RWA	450
Capital requirements at A's subconso level	9%
Capital Requirements	41
CET1	100
CET1 ratio	22.2%

Step 2 - Perform the B's consolidated BS and determine the A's RWA contribution for the conso level and corresponding capital requirements

B conso (the same as the sub-conso)

Assets of A	450	Capital	**50**
Assets of B	90	MI A	20
		Debt	470
	540		540

RWA that arise from A	450
Capital requirements at B's conso level	8%
Capital Requirements	36

Step 3 - Calculate the eligible MI that would arise from the shareholder capital of A to B's CET1 by article 79

Total accounting MI from A	20
A's CET1	100
Capital Requirements by 79(1)(a)(i)	41
Capital Requirements by 79(1)(a)(ii)	36
%MI in A	20%

Total eligible MI from A to B conso level	**7.2**	**=F53-(F54-MIN(F55;F56))*F57**

Step 4 - Present the regulatory BS for B and calculate CET1 ratio for B conso basis

B conso (the same as the sub-conso)

Assets of A	450	Capital	**50**
Assets of B	90	MI A (eligible)	7.2
		MI A (non- elig.)	12.8
		Debt	470
	540		540

RWA	540	=(B65+B66)*$F$5
Capital requirements at B's conso level	8%	=$C$6
Capital Requirements	43	=I66*I65
CET1	57.2	=D65+D66
CET1 ratio	10.6%	=I68/I65

Chapter 2 - Calculation of the CET1 of M

In the language of article 79:

M is considered as the "Institution"

A and B are considered as "subsidiary"

A on a subconsolidated basis is, in fact, its solo basis as A does not have any other subsidiary of its own that is consolidated at the level of B.

B on a subconsolidated basis corresponds to the subconsolidated level of B (i.e. consolidating A)

Section 1 - In order to calculate the Eligible MI from the shareholder capital of A to the CET1 ratio of M, we have:

Step 1 - Perform the A's subconsolidated BS

A subconso (the same as the solo)

Assets of A	450	Capital	**100**
		Debt	350
	450		450

RWA	450
Capital requirements at A's subconso level	9%
Capital Requirements	41
CET1	100

Step 2 - Perform the M's consolidated BS and determine the A's RWA contribution for the conso level and corresponding capital requirements

M consolidated

Assets of A	450	Capital	**185**
Assets of B	90	MI A	20
intangibles	150	MI B	15
		Debt	470
	690		690

RWA that arise from A	450
Capital requirements at M's conso level	8.5%
Capital Requirements	38.25

Step 3 - Calculate the eligible MI that would arise from the shareholder capital of A to M's CET1 by article 79

Total accounting MI from A	20
A's CET1	100
Capital Requirements by 79(1)(a)(i)	41
Capital Requirements by 79(1)(a)(ii)	38
%MI in A	20%

Total eligible MI from A to M's conso level	**7.65**	**=F103-(F104-MIN(F105;F106))*F107**

Section 2 - In order to calculate the Eligible MI from the shareholder capital of B to the CET1 ratio of M, we have:

Step 4 - Perform the B's subconsolidated BS (same as Chapter 1 calculations)

Refer to steps 1 to 4 of Chapter 1 calculations as it calculates B's regulatory BS, on a sub-consolidated basis. Thus, the B's regulatory BS is the one presented in Step 4 of Chapter 1:

B conso (the same as the sub-conso)

Assets of A	450	Capital	**50**
Assets of B	90	MI A (eligible)	7.2
		MI A (non-elig.)	12.8
		Debt	470
	540		540

RWA	540
Capital requirements at B's conso level	8%
Capital Requirements	43
CET1	57.2
CET1 ratio	10.6%

Step 5 - Perform the M's consolidated BS and determine the B's RWA contribution for the conso level and corresponding capital requirements

M consolidated

Assets of A	450	Capital	**185**
Assets of B	90	MI A	20
Intangibles	150	MI B	15
		Debt	470
	690		690

RWA that arise from B (sub-conso)	540
Capital requirements at M's conso level	8.5%
Capital Requirements	45.9

Step 6 - Calculate the eligible MI that would arise from the shareholder capital of B to M's CET1 by article 79

Total accounting MI from B	15
B's CET1	57.2
Capital Requirements by 79(1)(a)(i)	43
Capital Requirements by 79(1)(a)(ii)	46
%MI in B	30%

Total eligible MI from B to M's conso level	**10.8**	**=F138-(F139-MIN(F140;F141))*F142**

Section 3 - CET1 ratio of M

Step 7 - Present the regulatory BS for M and calculate CET1 ratio for M, on a conso basis

M consolidated

Assets of A	450	Capital	**185**
Assets of B	90	MI A (eligible)	7.65
Intangibles	150	MI A (non-elig.)	12.35
		MI B (eligible)	10.8
		MI B (non-elig.)	4.2
		Debt	470
	690		690

RWA	540	=(B152+B153)*$F$5
Capital requirements at M's conso level	8.5%	=$C$7
Capital Requirements	46	=I153*I152
CET1	53.45	=D152+D153+D155-B154
CET1 ratio	9.9%	=I155/I152

4.2 Accompanying documents

4.3 Draft Cost- Benefit Analysis / Impact Assessment

4.3.1 Introduction

1. As per Article 10(1) of the EBA regulation (Regulation (EU) No 1093/2010 of the European Parliament and of the Council), any draft implementing technical standards/regulatory technical standards/guidelines developed by the EBA – when submitted to the EU Commission for adoption - shall be accompanied by an Impact Assessment (IA) annex which analyses 'the potential related costs and benefits'. Such annex shall provide the reader with an overview of the findings as regards the problem identification, the options identified to remove the problem and their potential impacts.

4.3.2 Problem definition

Issues identified by the European Commission (EC) regarding own funds

2. As documented in the Impact Assessment accompanying the CRR, the EU banking system entered the financial crisis holding capital resources of insufficient quantity and quality. In particular, the European Commission identified the following **problem drivers:**[13]
    i. Certain capital instruments did not fulfil loss absorption, permanence and flexibility of payments criteria.
    ii. Regulatory adjustments were not being applied to the relevant layer of an institution's regulatory capital.
    iii. Regulatory adjustments were not harmonised among Member States.
3. Problem drivers (i) to (iii) are addressed notably in Part Two, title one (own funds) and Part ten, Title one (transitional provisions) of the CRR. In order to address those problem drivers, the EU Commission defined the following **operational objectives**:

    A. To enhance loss absorption, permanence and flexibility of payments of going-concern capital instruments;
    B. To enhance loss absorption of regulatory capital by appropriate application of regulatory adjustments from the relevant layers of capital;
    C. To develop a harmonised set of provisions in the area of definition of capital.

4. By realising the objectives above, capital requirements contribute to achieving the **general objectives** of financial stability and depositor protection.

[13] Cf. the impact assessment accompanying the CRR: http://ec.europa.eu/internal_market/bank/docs/regcapital/CRD4_reform/IA_regulation_en.pdf

5. The general approach followed in the CRR, for the realisation of those objectives, consists in modifying both eligibility criteria and regulatory adjustments as adopted by the Basel Committee while allowing for adjustments that are necessary to take due account of EU specificities[14].

Issues addressed by the RTS and objectives

6. The proposed draft RTS supplements at a technical level the provisions of the CRR, with the aim of contributing to the realisation of the objectives described in the previous section, in accordance with the mandate received by the CRR, and with due account of the CRR approach of adapting the Basel Committee's measures to the specificities of the EU financial markets.

7. The draft RTS specify the rules and conditions to ensure a harmonised application of the different CRR provisions addressing problem drivers (i) to (iii) and operational objectives (A) to (C) on the following topics:
    a. Deductions of direct, indirect and synthetic holdings;
    b. Broad market indices to be used for determining distributions on Additional Tier 1 and Tier 2 own funds instruments;
    c. Minority interests included in consolidated Common Equity Tier 1 Capital;

8. The provisions on the topic of indirect and synthetic holdings in other financial sector entities address the problem of inadequate loss absorption capacity of own funds' resources, as well as the inadequate application of regulatory adjustments (deductions from capital). The draft RTS focuses on the mathematical procedures needed to compute the exposure resulting from indirect holdings of own funds instruments. The operational objective of the RTS is one of ensuring that full clarity is provided on the proposed methods for computing indirect participations, while guaranteeing that the methods accommodate the different existing structures of indirect participation of an institution in another financial sector entity.

9. Also, the draft RTS takes into account the proportionality of the proposed mathematical 'look-through' approach and its implications for the compliance burden imposed on institutions.

10. The provisions on the use of market indices for indexing distributions on AT1 and T2 own funds instruments constitute one way of addressing the problem of inadequate features of loss absorption, permanence and flexibility of payments of own funds resources (see in previous section *problem driver (i)* and associated *operational objective A*). Whenever an institution issues AT1 or T2 instruments paying investors an interest rate which is linked/indexed to a market index type of 'average price' of interbank lending/borrowing, the possibility arises that following a decline in its own credit standing, and/or a worsening of its financial condition, the issuer pays a higher interest rate on the AT1 or T2 instruments. This outcome is likely to occur when the market index under consideration is highly correlated with the performance of the issuing institution, due to the issuing institution being a heavy component in the calculation of the index.

[14] See Policy option 3.5 in the "Eligibility of capital instruments and application of regulatory adjustments" section of the EC Impact assessment accompanying the CRR.

11. Any such credit-sensitive feature of dividend payments is deemed to undermine the loss absorbency capacity of institutions' own funds, by requiring them to distribute larger amounts of resources during times of financial stress when, due to a own credit risk worsening, they should instead be retaining more capital resources.

12. The draft RTS provides the set of necessary conditions defining a 'broad market index', i.e. a market index that can be used as base for determining the level of distributions on Additional Tier 1 and Tier 2 instruments. The objective of the RTS, in this respect, is to strike the right balance between the need to ensure independence in the processes governing the index creation and low levels of correlation of the index with individual participants to the creation of the index, on the one hand, and the need to guarantee institutions operating in both local and cross-border markets the access to available indices for referencing the remuneration of own funds instruments on the other.

13. The provisions on the topic of minority interests address the problem of inadequate loss absorption capacity and permanence of own funds resources. The recent financial turmoil, in this respect, showed that own funds resources owned by minority parties within subsidiaries can prove to be less available for supporting the losses of the group to which the subsidiary is consolidated than to the subsidiary itself. The draft RTS defines, in particular, the mathematical calculation to be used for the calculation of the 'eligible minority interest', i.e. the minority interest own fund resources that can be included in the own fund resources of the consolidating entity.

4.3.3 Baseline

14. The current CRD provisions (2006/48/EC) require the deduction of investments in financial entities but do not establish deduction rules for investmentsheld through indirect and synthetic holdings. The CRR provisions on such indirect and synthetic holdings are therefore new regulatory approaches. Also the provisions on minority interests and the use of 'broad' market indices are new regulatory approaches not present in the current CRD framework (2006/48/EC).

4.3.4 Considered approaches and expected impact of the proposals

Indirect and synthetic holdings

15. As a result of the provisions on the deduction of indirect and synthetic holdings of own funds instruments of other financial sector entities, and depending on the current levels of conservatism in the treatment of such deductions in the different EU jurisdictions, institutions domiciled in some jurisdictions are likely to face tighter capital requirements. The aggregate outcome on capital requirements cannot be inferred given the lack of sufficiently detailed data on the current regulatory treatment of deductions for indirect and synthetic holdings in other financial sector entities.

16. The draft RTS proposes two methods for the calculation of indirect holdings, depending on the ultimate structure of such holdings (serial/parallel). The two methods are deemed to be applicable

to all sorts of structures of indirect participation, ultimately being reduced to either a serial or a parallel indirect holding structure.

17. The aim of the alternative proposal of full deduction of the participation in the intermediate entity is twofold:

    a. To incentivise institutions to carry out a look-through approach in all those cases where the institution expects the deductions resulting from such approach to be less conservative, and hence less material, than the deduction implied by the alternative approach.
    b. To provide institutions with a proportionate alternative to the look-through approach in those cases where the look-through approach is deemed overly burdensome and hence not justified by the prudential outcome resulting from the look-through deductions.

Broad Market Indices

18. Data is not available on the characteristics of all market indices currently used for benchmarking the remuneration of AT1 and T2 instruments in EU jurisdictions and in local markets within the jurisdictions. Therefore no assessment can be done on the number and location of the institutions that are going to have to change market indices used for the purposes of benchmarking remuneration in order to comply with the proposed criteria defining 'broad market indices'.

19. The following subsections illustrate advantages and disadvantages of the approaches considered, and adopted, in the drafting of the provision dealing with market indices.

<u>General approach</u>

20. In drafting the provisions on broad market indices two approaches were considered:

    1. An 'exclusive list' approach where the draft RTS enumerates the inter-bank lending indices that shall be considered 'broad market indices'.
    2. A principles-based approach where the draft RTS describes the features that broad market indices shall present, both in terms of use of the index in the markets and limits of correlation in the construction of the index.

21. Approach (1) is not proposed in the draft RTS: although it would probably maximise the extent of rule harmonisation and legal clarity, an exhaustive list of indices represents a non-flexible regulatory approach that is always susceptible of excluding appropriate items, i.e. either currently existing indices or indices to be introduced in the future.

22. Approach (2), based on principles, is deemed to implement the right balance between the necessity to guarantee independence and granularity of the indices, on one hand, and the

flexibility needed on markets where available indices have to be identified for use as ‘broad market indices’.

Minority interests

23. The treatment of minority interests own funds resources, for the purposes of consolidating own fund resources of a subsidiary to the own fund resources of the related group, differs across jurisdictions in the EU. It is expected that, for those jurisdictions where minority interests can currently fully contribute to the capital requirements of the consolidating group, the proposed deductions related to minority interests result in consolidating groups facing tighter capital requirements. Data is not available, however, to estimate the potential aggregate fall in available eligible capital resulting from the proposed deduction of minority interests.

4.4 Overview of questions for Consultation

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

Q02: Provisions included in paragraph 1of 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.

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?

Q04: Do you agree with the examples of synthetic holdings provided in paragraph2of the following Article 14a? Should other examples be added to this list?

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?

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?

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

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

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?

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?

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)?

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 a supervision on a sub-consolidated basis. What would you propose as conditions?