Realkreditrådet
ASSOCIATION OF
DANISH MORTGAGE BANKS

To: EBA

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Answer submitted by:
Realkreditrådet (Association of Danish Mortgage Banks)

Subject: EBA/CP/2012/02

Response to EBA Consultation Paper on Draft Regulatory Technical Standards on Own Funds - Part one.

General comments

The Association of Danish Mortgage Banks welcomes the opportunity to comment the EBA Consultation Paper on Draft Regulatory Technical Standards on Own Funds - Part one.

We are generally concerned about the treatment of Additional Tier 1 instruments that cannot be converted into shares but must be written down in a crisis situation. The conditions governing write-downs and write-ups seem unnecessarily restrictive and may have serious consequences for the ability of mutuals to issue Additional Tier 1 instruments. Please see responses to Questions 12 and 13.

Additional Tier 1 instruments absorb a disproportionately great share of losses when a trigger has been met. Therefore, it must be ensured that investors in these instruments are not also treated worse than share investors when economic conditions are improving. Otherwise, investors will not find the instruments attractive – this cannot be in the interest of the authorities given that Additional Tier 1 instruments are defined as capital instruments in the CRR.

Responses to specific questions

Q12. Are the provisions on the procedures and timing surrounding a trigger event and the nature of the write-down sufficiently clear? Are there issues which need to be elaborated further?

According to Article 51(1)(aa) of the Council general approach, it is possible to specify trigger events in addition to the event referred to in Article 51(1)(a). We assume that if a credit institution issues Additional Tier 1 instruments with an additional write-down trigger event in accordance with Article 51(1)(aa) of, say, 8%, the institution may lay down conditions in the prospectus that differ from the requirements of Article 20(3) of the Regulatory Technical Standards. This could be for instance more lenient write-up conditions than those described in Article 20(3) of the Regulatory Technical Standards. The requirements of Article 20 will not

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have to be met until Common Equity Tier 1 meets the trigger specified in Article 51(1)(a) of, say, 6%. We would like you to confirm this interpretation.

Q13 How would you assess the impact of the provisions to be applied to temporary write-downs and write-ups?

The conditions specified in Article 20(3) and illustrated in the Annex will severely affect the issuance of Additional Tier 1 instruments with a subsequent write-up option for the following reasons:

- Additional Tier 1 instruments absorb a disproportionately great share of losses. We do not find that the loss distribution illustrated in the Annex is consistent with the requirement that Common Equity Tier 1 must absorb the first and proportionately greatest share of losses. However, we do recognise that the institution will be less loss-absorbent if it writes down the instruments proportionately rather than converting them upon a trigger event, as it will cause the Common Equity Tier 1 capital ratio to drop below the minimum level of 4.5% sooner.

- Following write-down, the terms of investors in Additional Tier 1 instruments will deteriorate compared with those of share investors. Shareholders may receive dividend, while investors in Additional Tier 1 instruments do not receive any payment. The rules have thus been tightened compared with Basel III, as non-EU institutions may issue instruments with dividend stoppers, while EU institutions may not. This creates an unlevel playing field, which will disadvantage investors in Additional Tier 1 instruments in particular. Furthermore, it could be argued that a write-up is preferable to distributing dividend since in the first case capital is retained within the institution.

- Any write-up of Additional Tier 1 instruments will be very slow, particularly if capital has been contributed – both during crisis management and after. Compared with share capital or converted Additional Tier 1 instruments, it will take a long time before the investment has been re-established.

Amendment to the Technical Standard

A possible amendment to Article 20(3) could be the following:

Article 20(3)(c) is amended to the effect that any write-up is subject to the constraints arising from points (d) and (f) but not (e).

This allows issuers discretionary write-up, but subject to a) compliance with buffer requirements, b) acceptance by local supervisors and c) such write-up being proportionate between the Tier 1 instruments that have been written down.

The proposal may cause uncertainty as to whether issuers may introduce a lenient write-up approach that could prevent recapitalisation. In that respect, it should be noted that it is up to the shareholders, as owners, to ultimately recommend a write-up. Consequently, the proposals do not prevent recapitalisation.

Finally, we see a need for the authorities to look carefully into the interaction between the proposal for a Directive on Recovery and Resolution submitted by the Commission on 6 June and the Capital Requirement Regulation currently in the trialogue. In particular, it is unclear how the trigger of temporary write-down of Additional Tier 1 instruments works compared with the trigger of permanent write-down.

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We would be pleased to elaborate on our comments, if so requested.

Yours sincerely

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