Asociación Española de Banca

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Spanish Banking Association

Secretary General

Pedro Pablo Villasante

European Banking Authority
Tower 42
25 Old Broad Street
London EC2N 1HQ
United Kingdom

Madrid, July 4th, 2012

Dear Sirs,

Subject: ***Consultation paper on Draft Regulatory Technical Standards on Own Funds***

The AEB[1] welcomes the efforts of the EBA with the publication of Draft Regulatory Technical Standards on Own Funds.

In this sense, we are pleased to contact you to express our support to the EBF´s position on the above mentioned subject, which will be sent to you today.

Additionally, with regard to the requirements of national tax laws for the conversion of the deferred tax assets into claims on the central governments described in article 36.2 (c) of the CRR, we would expect to receive more specific details related to its interpretation..

Question stated in the Consultation paper

Q07. Are the provisions on the deductions related to losses for the current financial year, deferred tax assets, defined pension fund assets and foreseeable tax charges sufficiently clear? Are there issues which need to be elaborated further?

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[1] The **Spanish Banking Association (AEB)** is the voice of the Spanish banking sector representing and defending the collective interests of banks operating in Spain (92 member banks: 59 Spanish and 33 credit entities' branches of foreign banks operating in Spain), with total consolidated assets of € 2,328 billion as of December 2011 and 107,492 employees in Spain.

Contact details: e-mail aeb@aebanca.es, **web:** www.aebanca.es

Velázquez, 64-66 - 28001 Madrid – Telephone: +34 91 789 2436 - Fax: +34 91 789 7821 – secretaria.general@aebanca.es

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Comment relates to article 36.2 (c) of the CRR stating the following:

"Article 36
Deferred tax assets that do not rely on future profitability
1. (...)
2. Deferred tax assets that do not rely on future profitability comprise the following:
(a) ...
(b) ...
(c) deferred tax assets arising from temporary differences which, in the event the institution incurs a loss, becomes insolvent or enters liquidation, are replaced, on a mandatory and automatic basis in accordance with the applicable national law, with a claim on the central government of the Member State in which the institution is incorporated which shall absorb losses to the same degree as Common Equity Tier 1 instruments on a going concern basis and in the event of insolvency or liquidation of the institution."

Comment

In order to clarify the requirements of national tax laws for the conversion of the deferred tax assets into claims on the central governments described in article 36.2 (c), it should be clarified that it would be enough that such conversion operates only in one of the three events foreseen in said article (loss, insolvency or liquidation) without being necessary that it operates in each and every one of them. This clarification would avoid uncertainties on the scope that the reforms of the different national tax laws may require for making effective this specific exemption of the deduction from Common Equity Tier 1 (CET1), if so desired.

Rationale

The rationale to impose a deduction of certain deferred tax assets from CET1 is that, under certain conditions, deferred tax assets might not have any realization value (e.g. should the institution be liquidated). Accordingly, once a national tax rule guarantees the realization value in events such as insolvency and liquidation, the deduction of these deferred tax assets from CET1 is not justifiable.

Because it would result in a disproportionate requirement, it is important to avoid the interpretation that for the purposes at hand, the conversion into claims on the central government of deferred tax assets should always operate in the case of losses. In many circumstances deferred tax assets still maintain a realization value even in the case losses are incurred: hence, losses can be of an extraordinary nature, can be non-recurrent, or can be incurred for amounts which are low or that do not generate a risk of insolvency or liquidation. For instance, it would not make sense that a national tax law has to recognize the conversion into a claim on the central government of such deferred tax asset if there is a loss of a low amount, if this tax law already recognizes such conversion in the events of either insolvency or liquidation. Of course conversion of a deferred tax asset into a claim on the central government in the case of losses should be an option that a government may decide to use, but not mandatory in itself.

Furthermore, in the case of credit institutions, the liquidation of the company and insolvency proceedings are often simultaneous. Although it is theoretically possible that any of these situations

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takes place separately it should be enough from a prudential point of view that the tax rules provide for the transformation in only one situation to ensure the effectiveness of the capital.

Liquidation needs not always to be accompanied by an insolvency procedure, as it is possible that the net equity is sufficient to meet the demands of depositors and satisfy all remaining creditors, regardless of the rank of their claims. In any case, if liquidation is not accompanied by an insolvency proceeding, and the tax legislation does not provide for the conversion into a claim of deferred tax assets in this scenario, the proceeds from the realization of assets (not including the mentioned deferred tax assets) should be sufficient to repay all debts of the entity. Therefore, the fact that the deferred tax assets have not been converted into a claim is not relevant from a prudential point of view because only the ordinary shareholders will be affected.

With respect to insolvency proceedings, it can be observed that unlike the business of any company in other economic sectors, the activity of a credit institution is based on the confidence of depositors and other creditors and, once this has disappeared, its viability as an independent entity is extremely difficult. Thus, if insolvency is not a triggering event, the possible intervention by the public sector, taking control of the entity, should be resolved in a short period of time with the liquidation of the said entity or their transfer, conveniently capitalized, to private hands. In the first case, the deferred tax assets would become claims on the central government, in the second, would retain its value realization, because the injection of new capital will enable future profits.

Proposal

It is proposed that for the avoidance of doubts the EBA clarifies in its final Regulatory Technical Standards, with respect to the requirements of national tax laws for the conversion of the deferred tax assets into claims on the central governments described in article 36.2 (c), that these requirements are met if the conversion operates only in one of the three events foreseen in said article (loss, insolvency or liquidation) without being necessary that it operates in each and every one of them.

Best regards,

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