ABI Associazione Bancaria Italiana

ABI response to the EBA Consultation Paper on Draft Regulatory Standards on Own Funds - Part One (EBA/CP/2012/02)

July 2012

POSITION PAPER

Introduction

The Italian Banking Association (ABI) welcomes the opportunity to comment on the EBA Consultation Paper on "Draft Regulatory Technical Standards on Own Funds".

ABI supports the EBF's Position Paper on the Additional Tier 1 Instruments (below AT1 Instruments).

In the following section, we address a number of specific questions put forward by the EBA on the same issue, respecting the order of questions as they appear in the consultation paper.

Detailed remarks

Title II - Elements of own funds

Chapter 2 - Additional Tier 1 Instruments

Section 1 (Form and nature of incentives) - Art. 19

Q.11 Would you agree on the types of incentives to redeem as described in paragraph 2? Should other types of situations be considered as incentives to redeem?

In principle, we agree on the types of incentives to redeem. The existence or non-existence of an incentive to redeem should be assessed at time of issuance.

We understand from the wording "these shall include" that the list under article 19.2 is not limitative. If so, under which circumstances could additional items be added?

Article 19.2 (b) is worrisome in this context. Article 19.2.(f) may be suitable as a 'catch all', but this article is too vague in our view. When does one suggest that an instrument will be called?

Section 2 (Conversion or write down of the principal amount) - Art. 20, Art. 21, Art. 22

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?

Q.13. How would you assess the impact of the provisions to be applied to temporary write-downs and write – ups?

The procedures regarding the nature of the write-down of the principal amount are not clear and significant problems arise.

Article 20, paragraph 1, items (a) (b) (c) state that:
- the aggregate amount to be written down shall be at least the amount needed to immediately return the institution's Common Equity Tier 1 ratio to the level laid down in article 51 (a) of CRR or if this not possible, the full principal value of the instruments;
- the write down shall lead to an increase in equity, under the relevant accounting standards, that is eligible as Common Equity Tier 1 Capital pursuant Article 24 of the CRR;
- the write downs shall apply on a pro rata basis to all holders of AT1 instruments that include a similar write down mechanism and an identical trigger level.

The example provided in the Annex confirms that in the case of write-downs, the AT1 investors are treated worse than equity holders as they lose the whole amount of the instruments while the equity holders lose only a part.

In this way, the ranking between Common Equity and Additional Tier 1 Instruments is not preserved; it also restricts the "marketability" of the instrument.

We understand that the EBA's intention is to consider the AT1 function during a write-down, similarly to common equity. If so, it should at least be allowed to write down the amount of the Additional Tier 1 instruments on a *pari passu* and *pro rata* basis with common equity Tier 1 (below CET1).

Article 20, paragraph 3 proposes, in particular, that for the write-down to be considered temporary:

(a) all payments shall be cancelled while the write-down is in effect, until the nominal amount of the instrument is fully reinstalled.
(c) any write up of the instrument shall be operated at the full discretion of the institution subject to the constraints arising from the points (d) to (f) of the same article.

Such provisions put AT1 holders in a worse position than CET1 holders again.

We see no reason why payments on AT1 instruments should be restricted while a write-down is in effect, given that distributions may: i) be paid to shareholders (on current CRD4 proposal, dividend stoppers are prohibited in Tier 1 instruments, paving the way for full discretion and asynchrony in dividend and coupon payments) ii be cancelled at any point in time by the relevant Regulators.

We also feel a coupon stopper should not be introduced when the temporary write-downs are in effect. It should be left to the issuer's discretion whether or not to pay a coupon with reference to the outstanding nominal value that is not written down.

With reference to point (c) - regarding the issuer’s full discretion on write-ups - we think automatic write-ups based on a *pari passu* and *pro rata* mechanism between AT1 and CET1 should be allowed if the institution reinstates the Common Equity Tier 1 distributions, subject to the restrictions laid down in the following (e) and (f) points of the same Article.

Regarding Article 20, paragraph 3 (b), we think that write-ups should not be based solely on profits but on any generation of Common Equity Tier 1, which can be RWA reduction or variation of reserves (e.g. if unrealised losses revert back to a higher value).

Section 3 (Features of instruments that could hinder recapitalization)- Art. 23

We recommend considering the features indicated by CEBS in the Implementation Guidelines for Hybrid Instruments (par. 110 – 113) on 2009, 10 December.