03/07/2012

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

Introduction

The Swedish Bankers' Association welcomes the opportunity to comment on the consultation paper on the draft RTS on Own Funds.

Main comments on the draft RTS

Since the RTS will be directly applicable in the Member States it is crucial there are no concerns regarding the application of the RTS. In the draft RTS there are several provisions that opens up for interpretation by the national competent authorities and as a consequence national discretion. This might lead to non harmonised application of the RTS. In addition it is of great importance for the EBA to keep within the mandate given through the EU-regulation.

Detailed comments

Article 2 Meaning of foreseeable charge or dividend under Article 24(2)(b) of the CRR

Q01. Are the provisions on the meaning of foreseeable when determining whether any foreseeable charge or dividend has been deducted sufficiently clear? Are there issues which need to be elaborated further? What would be your definition of foreseeable?

In paragraph 4 subparagraph 2 it is stated that *exceptional dividends during the period* should be excluded from the calculations. The nature of exceptional dividends/distributions is that they are made due to very specific circumstances, for example following a sale of a significant subsidiary the proceeds might distributed to the owners in the form of dividends instead. If such dividends were to be included in the calculation this would imply that they are in fact not exceptional, since they would form part of the projected future ordinary dividends, which is of course counter intuitive. Exceptional dividends should therefore not be a part of the calculation at all.

Besök (Visit):
Regeringsgatan 38
Stockholm
Sverige (Sweden)

Post:
Box 7603
SE-103 94 Stockholm
Sverige (Sweden)

t: +46 (0)8 453 44 00
f: +46 (0)8 796 93 95
e: info@swedishbankers.se
www.swedishbankers.se

Therefore, the wording of the provision should be changed.

Drafting suggestion
[...]
4. The dividend payout ratio shall be determined on the basis of the dividend policy approved by the management body or other relevant body. In the absence of an approved dividend policy, or when, in the opinion of the competent authority, it is likely that the institution will not apply its dividend policy or this policy is not a prudent basis to determine the amount of deduction, the dividend payout ratio shall be based on the highest of the following, where exceptional dividends paid during the period should be excluded:
(a) the dividend payout ratio calculated as an average of the dividend payout ratios of the three years prior to the year under consideration;
(b) the dividend payout ratio of the year preceding that of the year under consideration.
The competent authority may authorise the institution to adjust the calculation of the dividend payout ratio as described in points (a) and (b) ~~to exclude exceptional dividends paid during the period~~.[...]

In addition, there are different national company law regimes to consider. These rules related to dividend distribution can differ substantially and the requirement in the RTS cannot be addressed to cover all countries. Until a European company law regime is established, only national administrative practice will be able to take account of features specific to national company law. The RTS must be stated in a way that will not be in contradiction to existing national laws within its range.

Regarding paragraph 7 there is uncertainty about the process for the consent of the competent authority. Consent from competent authority should normally not be needed to include interim or year-end profits, when all provisions are met.

Drafting suggestion
[...]
7. The competent authority shall be satisfied that all necessary deductions to the interim or year-end profits and related to foreseeable charges have been made, either under applicable accounting rules or under any other adjustments.~~, before consenting that the institution includes interim or year-end profits in Common Equity Tier 1 capital.~~

Article 6 Applicable forms and nature of indirect funding of capital instruments under Article 26(1)(b) and 49(1)(c) of the CRR

Q02. Are the provisions on the applicable forms of indirect funding of capital instruments sufficiently clear? Are there issues which need to be elaborated further?

Q03. How do you assess the provisions on related parties regarding the necessity to assess on an on-going basis that the related party has sufficient revenues?

The provision is rather far-reaching as it does not require the institution to be aware of the indirect financing. We are of the opinion that clarification in this area is needed. The writing should be complemented with some sentence stating how far the investigation of the institution should reach and what is reasonable. The suggested wording on indirect funding could otherwise be operationally very burdensome for the institutions. Our view is that it should be clarified how far the institution needs to go, without it being unreasonable operationally burdensome.

Drafting suggestion
"The institution should with reasonable effort investigate that the conditions as stated in xxx is not likely to take place"

Article 13 Deduction of defined benefit pension fund assets under Article 33(1)(e) of the CRR [and Article 38(1)(b) of the CRR]

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?

According to the provision a prior consent is to be granted only when the access to the assets is *immediate.* One interpretation of the provision might be that the assets shall be accessible at all times. Given that a board decision may be required to access assets in a pension fund some time is needed in between the prior consent of the competent authority and the access to the assets. To reflect this in the RTS a possible solution might be to be replaced *immediate* with *without delay*.

Drafting suggestion
The competent authority shall only grant the prior consent mentioned in point (b) of Article 38(1) of the CRR where the unrestricted ability to use the assets entails ~~immediate and~~ unfettered access to the assets without delay, such as when the use of the assets is not barred by a restriction of any kind and there are no claims of any kind from third parties on these assets.

Article 20, 21, 22, 23

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?

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

Article 20 Nature of the write-down of the principal amount under Article 49(1)(n) of the CRR

We are of the opinion that coupon payments should only be cancelled on written-down amounts. In addition, we believe that the EBA exceeds its mandate in this provision by introducing a restriction on how coupons can be paid. If the EBA thinks that there is a need to regulate how coupons can be paid on instruments with temporary write-down, the mandate in the CRR needs to be extended. In article 49.2 (b) of the CRR it is stated that the EBA shall develop draft regulatory technical standards to specify the nature of the write-down of the principal amount. The draft RTS also regulates payments while write-downs are in effect, which is beyond the EBAs mandate. In this case the draft RTS even goes beyond the CRR by requiring that for the write-down to be considered temporary all payments shall be cancelled while the write-down is in effect, until the nominal amount of the instrument is fully reinstated. The CRR is merely stating that where the provisions governing the instruments require their principal amount to be written down upon the occurrence of a trigger event, the write-down shall reduce the distributions made on the instrument. This is in line with what the draft RTS is proposing for instruments with a permanent write-down feature where payments are proposed to be allowed on the basis of the reduced principal amount. We see no reason to treat instruments with permanent write-down features and instruments with temporary write-down features differently. A requirement that payments shall be fully cancelled while the write-down is in effect will also mean that AT1 holders are worse off than shareholders, who are in a position to receive dividends while the instrument is written down, thus distorting the hierarchy of the capital structure. Consequently, the AT1 coupon stopper should be removed to enable partial AT1 coupons (as well as common dividends) to be made from "spare" MDA (maximum distributable amount).

Further, we believe that the write-up mechanism needs to be changed. Since the shareholders will have the full benefit of any capital that is retained within the bank, the incorporation of a maximum distributable amount (MDA) will in essence not be a capital restriction on the owners of the bank. In most cases it will actually benefit the shareholders since it will *ex post* cut earned but unpaid distributions to other parties such as employees and investors in capital instruments. Since earnings excluded from the MDA fully benefits shareholders, we favour a write-up feature where the banks shareholders have full discretion to allocate the funds included in the MDA in a way that they feel best supports the business of the bank. This might very well be to allocate the entire MDA for the writing-up of AT1 instruments. Furthermore, banks should have the right to include a predetermined allocation mechanism in the terms and conditions of the capital instruments. We also believe that the proposed maximum allocation mechanism in point (e) is highly unfortunate:

- Firstly it will lead to instruments issued by institutions that have a highly leveraged capital base to be written up quicker than institutions with only a small portion of outstanding additional tier 1 instruments. This will presumably

also make the proportion of AT1 instruments to total T1 more important (or at least as important) in terms of market accessibility and pricing, than the absolute level of CET1, T1 and T2 to the overall risk of the institution. Consequently an institution where the entire T1 consists of CET1 might end up having to pay more for issuing AT1, than it would have had to do if its T1 already included AT1 instruments; this even though the initial level of total T1 is assumed to be the same.

- Secondly, it doesn't take account of how losses have been allocated between different tiers of the capital base. If, for example, a trigger breach is caused by an increased level of risk (i.e. an RWA increase) rather than actual losses, an AT1 instrument might be written down even though CET1 has not decreased (and might even have increased). Leaving AT1 holders with a lower claim and shareholders with the right to both the initial CET1 and the corresponding written down amount from the AT1 instruments. If the risk level decreases the write up will still be contingent on the initial AT1/T1 ratio, even though AT1 holders alone have sustained losses.

The fact that there exists a regulatory definition of MDA, and that any individual institutions MDA can be adjusted by competent authorities in accordance with article 132 of the Directive, should be enough to address any concerns that a write-up feature would hinder recapitalisation of the bank.

Drafting suggestion

…

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

~~(a) all payments shall be cancelled while the write-down is in effect, until the nominal amount of the instrument is fully reinstated;~~

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

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

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

~~(e) the maximum amount to be attributed to the write-up of the instrument shall be based on the profit multiplied by the sum of the nominal of all Additional Tier 1 instruments before write-down that have been subject to a write-down divided by the total Tier 1 capital of the institution. This calculation shall be made at the moment when the write-up is operated;~~

~~(f)~~ (d) the sum of any write-up amounts shall be treated as a payment that results in a reduction of Common Equity Tier 1 and shall be subject, together with other

distributions on Common Equity Tier 1 instruments, to the restrictions relating to the Maximum Distributable Amount as laid down in Article 131 of the CRD, as transposed in national law or regulation.

Article 21 Procedures and timing for determining that a trigger event has occurred under Article 49(1)(n) of the CRR

According to the provision the conversion shall take place *immediately* once the amount to be converted has been determined. Since completion of a conversion requires some time after the amount to be converted has been determined we would prefer the wording without delay.

Drafting suggestion

[…] *(e) the write-down or conversion shall take place ~~immediately~~ without delay once the amount referred to in point (c) has been determined;*[…]

Article 22 Procedures and timing for notifying the competent authority and the holders of the instrument under Article 49(1)(n) of the CRR

We are of the opinion that it would be sufficient if the holders of the instruments are notified according to the terms of the instruments.

Drafting suggestion

Where the management body or any other relevant body of the institution has determined that a trigger event has occurred in accordance with point (a) of Article 21, the institution shall immediately notify the competent authority ~~and the holders of the Additional Tier 1 instruments~~ that a trigger event has occurred and that the instrument will be written down or converted in accordance with the provisions governing the instrument. The institutions shall notify the holders of the Additional Tier 1 instrument in accordance with the provisions governing the instrument.

Article 26 Indirect holdings arising from index holdings- Meaning of operationally burdensome under Article 71(2) of the CRR

Q14. Are the provisions on indirect holdings arising from index holdings sufficiently clear? Are there issues which need to be elaborated further?

The treatment regarding indirect participations stemming from index holdings are particularly complex. I should be preferred if a more simplified approach could be applied and a lower limit set, as example it could be assumed that the share of relevant entities in the reference index is less than x% or total exposure of index holdings is less than x% of total own funds.

Article 28 Process and data requirements for an application by an institution to carry out redemptions, reductions and repurchases - under Article 72(b) of the CRR

Paragraph 28.2 should be deleted. Instruments shall be taken into account as regulatory capital as long as the instrument is existent and the money is in the bank. If the EBA would stick to this proposal banks should be allowed to take into to account any replacement instrument even though it has not been issued. Especially in cases where the regulator requires a replacement for a call to be approved.

Article 31 Timing of the application to be submitted by the institution and processing of the application by the competent authority [Article 72(b) of the CRR]

Q18. How would you assess the impact of the proposed timing of 3 months for the submission of the application?

The proposed processing time of three months is compared to current Swedish conditions a prolongation of the processing time. The present processing time in Sweden is one month which we consider as a reasonable time. During a three months period there may occur changes that are not insignificant. Given this we would prefer that the competent authority always should have the possibility to allow institutions to transmit an application within a time frame shorter than three months.

It is also cumbersome that processing of the application shall begin only when competent authorities are *satisfied* they have received required information. This could arbitrarily prolong the submission period. We therefore propose a change in paragraph 2. Furthermore the reference in paragraph 2 should be to article 30.

Drafting suggestion

[…]

2. The competent authority shall process an application during the period of time referred to in paragraph 1. Competent authorities shall take into account new information, if any and if deemed material, received during this period. The processing of the application shall begin only when competent authorities have received from the institution ~~are satisfied that~~ the information required under Article 30 ~~28 has been received from the institution~~.

3. Competent authorities may allow institutions ~~on a case-by-case basis and under exceptional circumstances to~~ transmit the application referred to in paragraph 1 within a time frame shorter than the 3 months period.

SWEDISH BANKERS' ASSOCIATION

Johan Hansing

Maria Larsson