

## Consultation Paper

On draft regulatory technical standards

On own funds – multiple dividends and differentiated distributions (part four) under Regulation (EU) No 575/2013 (Capital Requirements Regulation – CRR)



---

# Consultation Paper on draft regulatory technical standards on own funds – multiple dividends and differentiated distributions (part four) under Regulation (EU) No 575/2013 (Capital Requirements Regulation – CRR)

## Contents

1.	Responding to this consultation	3
2.	Executive summary	4
3.	Background and rationale	6
4.	Draft regulatory technical standards on own funds – multiple dividends and differentiated distributions [part four] under Regulation (EU) No 757/2013 (Capital Requirements Regulation – CRR)	9
5.	Accompanying documents	20
5.1	Draft cost–benefit analysis/impact assessment	20
5.2	Overview of questions for consultation	24

---

## 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 section 5.2.

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.

### Submission of responses

To submit your comments, click on the 'send your comments' button on the consultation page by **24 January 2014**. Please note that comments submitted after this deadline, or submitted via other means, may 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

The protection of individuals with regard to the processing of personal data by the EBA is based on Regulation (EC) No 45/2001 of the European Parliament and of the Council of 18 December 2000 as implemented by the EBA in its implementing rules adopted by its Management Board. Further information on data protection can be found under the [Legal notice section](#) of the EBA website.

---

## 2. Executive summary

Regulation (EU) No 575/2013 (Capital Requirements Regulation – CRR) 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.

This Consultation Paper puts forward draft RTS related to Article 28(5) of the CRR, which mandates the EBA to specify whether and when multiple distributions would constitute a disproportionate drag on own funds, as well as the meaning of preferential distributions.

Under the CRR, and notably with reference to Recital 72 thereof, institutions may pay, on Common Equity Tier 1 (CET1) instruments with fewer or no voting rights, distributions that are a multiple of those paid on instruments with higher levels of voting rights. (In practice, in most cases institutions have one voting instrument, i.e. an instrument with 'full' or 'the highest' voting rights, which will be used as the reference for the distributions on the instruments with fewer or no voting rights). This is on the condition that the criteria for CET1 instruments are met, notably including those relating to the flexibility of payments.

These draft RTS aim at proposing harmonised criteria for instruments with multiple distributions. Capital instruments may include provisions giving rise to distributions that are different from those paid on voting CET1 instruments (differentiated distributions) or that are a multiple of the distributions paid on voting CET1 instruments. However, only a subset of those instruments would be considered not to create a disproportionate drag on capital, and could therefore be included in CET1 themselves. The draft RTS set out a way to identify that subset by proposing criteria to be met by those instruments. Those criteria are devised for joint stock companies (JS) and are then adapted in order to also take into account the specificities of non-joint stock companies (NJS).

Preferential distributions are deemed to exist when holders of CET1 instruments are at an advantage compared with other holders of CET1 instruments of the same institution, particularly regarding the timing and order of distribution payments. In addition, instruments where the distributions are in excess of the limits set with respect to multiple distributions are considered preferential.

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

- Regarding preferential distributions: to ensure that there is sufficient flexibility of payment for all CET1 instruments.
- Regarding instruments with multiple distributions: to ensure that the future loss absorbency of CET1 instruments is not compromised by disproportionate distributions constituting a drag on own funds. This should be achieved in a way compatible with the different capital structures existing in Europe and especially for institutions from the cooperative sector. In particular, joint stock companies may only issue, in addition to their instruments with full voting rights, instruments where the multiple is predetermined and non-revisable, as well as limited. Because of the specificities of the capital structure and of the voting CET1 instruments of NJS

---

companies, there are circumstances where the treatment outlined above shall not apply to those institutions.

As a consequence, two separate approaches have been developed, in order to distinguish between JS companies and NJS companies.

For JS companies, the ordinary voting shares are the most flexible instruments that an institution could use to increase equity. In most cases, there is no clear need for joint stock companies to issue shares without voting rights other than to protect the voting rights of their current shareholders. As this protection generally has a cost which may create a drag on capital, quantitative limits on the ability to have differentiated distributions due to different voting rights seem to be justified in most cases. These limits are expressed (i) in terms of the amount of distribution on one instrument with a dividend multiple compared with the amount of distribution on one voting instrument and (ii) in terms of the total amount of distribution paid on CET1 instruments.

For NJS companies, the EBA has proposed a differentiated approach taking into account the specificities of this type of institution. This is the reason why the approach proposed for NJS companies is not strictly based on the setting of hard quantitative limits, as for joint stock companies, but takes into account other factors such as the fact that the non-voting shares will be held by voting members, that voting shares are in some cases subject to a legal cap or that the level of distributions for NJS companies is in general limited. In addition, the EBA is investigating further the legal scope of the mandate to apply to these institutions.

These RTS will be part of the single rulebook aimed at enhancing regulatory harmonisation in Europe and namely at strengthening the quality of capital.

---

### 3. Background and rationale

#### Draft RTS on own funds – part four

On 26 June 2013, revised Capital Requirements Directive (CRD) and Capital Requirements Regulation texts were published in the Official Journal of the EU. These aim to apply the internationally agreed standards adopted within the context of the Basel Committee for Banking Supervision (known as the 'Basel III framework') in the EU.

The EBA has developed these RTS proposals in accordance with the mandates contained in Article 28(5) of the CRR.

#### The nature of RTS under EU law

The present draft RTS are produced in accordance with Article 10 of the EBA Regulation<sup>1</sup>. In accordance with Article 10(4) of the EBA Regulation, RTS shall be adopted by means of a regulation or decision.

In accordance with 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.

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 Directive 2006/48 (colloquially known as 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 from 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<sup>2</sup>. The second set of guidelines, published in June 2010, refers to elements of Article 57(a) of the CRD<sup>3</sup>.

In December 2010, the Basel Committee on Banking Supervision (BCBS) published its 'global regulatory framework for more resilient banks and banking systems', aiming to address the lessons

---

<sup>1</sup>Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC.

<sup>2</sup><http://www.eba.europa.eu/CMSPages/GetFile.aspx?nodeguid=97f3cd8f-855c-40de-a98b-b923e8eaa4ad>

<sup>3</sup>[http://www.eba.europa.eu/documents/Publications/Standards---Guidelines/2010/Guidelines\\_article57a/Guidelines\\_article57a.aspx](http://www.eba.europa.eu/documents/Publications/Standards---Guidelines/2010/Guidelines_article57a/Guidelines_article57a.aspx)

---

from the financial crisis. The section of the CRR that covers own funds in essence ‘translates’ the BCBS proposals into EU law. Both reforms raise both the quality and quantity of the regulatory capital base.

While recognising the possibility for institutions to issue instruments with dividend multiples, European co-legislators have introduced a mandate for the EBA to ensure that these features are framed in such a way that they do not lead to a disproportionate drag on capital, both in terms of single own funds instruments and total own funds. In this context, it is the EBA’s view that there are several reasons for applying a different treatment for non-voting instruments of NJS companies, at least in specific circumstances, compared to non-voting instruments of joint stock companies<sup>4</sup>, as set out below.

For joint stock companies, the ordinary voting shares are the most flexible instruments that an institution could use to increase equity. Those instruments are permanent, the dividend is fully flexible and if there is a need to raise equity, it is possible to make the ordinary shares attractive for new shareholders (notably by a decrease of the issue price and an increased dilution, without necessarily increasing the dividend pay-out). Hence, in most cases there is no clear need for joint stock companies to issue shares without voting rights other than to protect the voting rights of their current shareholders (which is not a primary prudential concern). As this protection generally has a cost which may create a drag on capital, quantitative limits on the ability to have differentiated distribution due to different voting rights seem to be justified in most cases.

For NJS companies, the EBA has proposed some provisions to be applied, since from a supervisory perspective a disproportionate drag on capital is also possible in such cases, although NJS companies’ specificities are reflected in the differentiated provisions that would be applicable to them. Nevertheless, given the unclear wording of the CRR, which creates some uncertainty about the legal scope of the EBA’s mandate, the EBA has written to the EU Commission in order to receive clarification regarding the scope. As a result, the present CP contains some draft legal text that would apply to NJS companies, if they were deemed to be covered by the scope of these RTS. The final draft RTS will take due account of the answer received from the EU Commission on the legal scope of the mandate.

In any case, and in the event that the NJS companies were deemed to be covered by the mandate of the RTS, the following would apply to them. In the case of NJS companies, the legal framework may be different, notably for cooperative societies. The cooperative shares (with voting rights) are generally issued at par, the return for the shareholders is generally limited to the dividend payment (no access to reserves in liquidation, redemption at par and no dilution effect when new shares are issued, no possibility to sell apart from redemption by the institution itself, as the institution generally constitutes the only market for its own capital instruments). In addition, the dividend payment on the voting shares may be subject to a cap and this may (notably when the cap on dividend is low) also reduce the ability of the cooperative society to raise capital through the issue of voting shares.

Another issue that may be taken into account is that most NJS companies apply the principle of ‘one man, one vote’. When the non-voting shares may be subscribed only by holders of voting shares,

---

<sup>4</sup>For the purposes of this Consultation Paper, ‘non-joint stock companies’ means institutions mentioned in Article 27 of Regulation (EU) 575/2013 and Articles 3 to 6 of this regulation. ‘Joint stock companies’ means institutions other than those.

---

issuing non-voting shares will not influence the level of voting rights. When shareholders have the flexibility to decide on the dividend to be paid on voting and non-voting shares, the situation of an institution where a shareholder subscribes one voting share and several non-voting shares will be the same as the situation of an institution where a shareholder subscribes several voting shares.

The requirement that the dividend multiple shall be predetermined and fixed for joint stock companies is justified by the concern that the non-voting shares should behave like voting shares, mainly in case of recapitalisation, where the non-voting shares should also be subject to dilution. For cooperative societies, even for voting shares, there is no clear dilution effect in case of recapitalisation.

This is the reason why the approach proposed for NJS companies is not strictly based on the setting of hard quantitative limits, as for joint stock companies, but takes into account other factors, such as the fact that the non-voting shares shall be held by voting members, that voting shares are in some cases subject to a legal cap or that the level of distributions for NJS companies is in general limited.



- 
4. Draft regulatory Technical standards on Own funds- multiple dividends and differentiated distributions[part four] under Regulation (EU) No. 757/2013 (Capital Requirements Regulation- CRR)



EUROPEAN COMMISSION

Brussels, **XXX**  
[...](2012) **XXX** draft

**COMMISSION DELEGATED REGULATION (EU) No .../..**

**of **XXX****

**on [...]**

**supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for Own Funds requirements for institutions**

---

## COMMISSION DELEGATED REGULATION (EU) No .../..

### **supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for Own Funds requirements for institutions**

#### **THE EUROPEAN COMMISSION,**

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

Having regard to Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012<sup>5</sup>, and in particular third subparagraph of Article 28(5) thereof,

Whereas:

(1) The drag on own funds should not be disproportionate in terms of both the distributions on any individual Common Equity Tier 1 instrument as well as the distributions on the total own funds of the institution. Therefore, the notion of a disproportionate drag on own funds should be established by providing rules covering both of these aspects.

(2) The meaning of preferential distributions should be based on features of the instruments that reflect the requirements of Article 28(1)(h)(i) of Regulation (EU) No 575/2013 that no preferential distribution treatment regarding the order of the distributions or other preferential rights should exist, including for preferential distributions of Common Equity Tier 1 instruments in relation to other Common Equity Tier 1 instruments.

(3) Non-voting instruments of institutions not referred to in Articles 3 to 6 of Regulation xx/xxx [*OF part 1/2 to be understood as draft RTS on own funds EBA/RTS/2013/01 as published on the EBA website*] (joint stock companies) may receive differentiated distributions relative to voting instruments, but all non-voting instruments should receive the same distribution which reflects the absence of voting rights. Instruments with fewer voting rights should be considered the same way as instruments with no voting rights in order to avoid the issuance of different classes of instruments with fewer voting rights and with different distributions.

(4) In some cases, specific rules should apply to the Common Equity Tier 1 instruments of institutions mentioned in Articles 3 to 6 of Regulation xx/xxx [*OF part 1/2 to be understood as draft RTS on own funds EBA/RTS/2013/01 as published on the EBA website*](non-joint stock companies). When only the holders of the voting instruments may subscribe to the non-

---

<sup>5</sup> OJ L 176, 27.6.2013, p. 1.

---

voting shares, then there is no deprivation of voting rights for holders of non-voting instruments. Therefore, the differentiated distribution on the non-voting instrument is not driven by the absence of a voting right in the same way as for joint stock companies. Also, when there is a cap on the distribution of the voting instrument, the limits devised for joint stock companies may not be applicable and should be replaced by other rules that ensure the absence of a disproportionate drag on capital.

(5) A different treatment for institutions mentioned in Articles 3 to 6 of Regulation xx/xxx *[OF part 1/2 to be understood as draft RTS on own funds EB/RTS/2013/01 as published on the EBA website]* relative to other institutions is only justified if the former institutions do not issue capital instruments with fewer or no voting rights, but with a predetermined multiple distribution, that would be set contractually or in the statutes of the institution. If they do, concerns relating to the potential drag on capital are the same as for institutions not referred to in Articles 3 to 6 of Regulation xx/xxx *[OF part 1/2]* and the same treatment should therefore apply.

(6) This should not prevent institutions mentioned in Articles 3 to 6 of Regulation xx/xxx *[OF part 1/2]* from issuing other capital instruments with differentiated distribution provided that they demonstrate that those instruments do not create an additional drag on capital. This demonstration should be based on the assessment of the level of distributions on voting instruments and the level of distributions on total Common Equity Tier 1. In order to justify distributions on non-voting instruments in excess of the limit imposed on joint stock companies, the institution should demonstrate that the level of distributions on the voting instruments is low by reference to other capital instruments and that the pay-out ratio on Common Equity Tier 1 instruments is low, even where the institution issues instruments with differentiated distributions. The limitation of the pay-out ratio – as well as rules prohibiting non-holders of the voting instrument to hold non-voting instruments - could however make recapitalisations more difficult. When a recapitalisation is needed or in similar circumstances, those rules could therefore be waived by competent authorities in order to give non-joint stock companies access to a broader market of investors.

(7) Regarding the level of distribution on the voting instrument, the institution should demonstrate that the level of distribution is low on the basis of distributions made on comparable instruments. For that purpose, the distributions on Common Equity Tier 1 instruments issued by comparable institutions, notably when they are established in the same Member state, may be taken into account, in particular regarding the distributions on those instruments when issued by institutions qualifying as a cooperative society, savings institution, mutual or similar institution under Article 3 to 6 of Regulation xx/xxx *[OF part 1/2]*. Alternatively, the level of distributions on subordinated instruments included in Tier 2 issued by the institution could be used as a benchmark as those instruments are senior to Common Equity Tier 1 instruments, and distributions at the same level as Tier 2 instruments should generally be low in comparison with distributions on equity instruments.

(8) With regard to the level of the pay-out ratio, a level of 30 per cent (for all Common Equity Tier 1 instruments issued by the institution) should be used as a benchmark. In order to take

---

into account that pay-out ratios may fluctuate depending on the yearly result, this level should be assessed on the basis of the average over the five previous years.

(9) Paying some but not all Common Equity Tier 1 holders is generally considered a preferential treatment. This is not the case when all holders of the non-voting instruments are also holding voting instruments, and when the voting instruments never receive distributions. In practice, the voting right and the distribution relating to one holder are split between two instruments.

(10) This Regulation is based on the draft regulatory technical standards submitted by the European Banking Authority to the Commission.

(11) The European Banking Authority has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010.

**Explanatory box:**

**Approach retained for the issuance of predetermined multiple distribution instruments**

Under article 28(5) of the CRR, institutions may issue instruments with differentiated distributions if and only if they have fewer or no voting rights.

Instruments with differentiated distributions can have predetermined multiple distribution instruments, where the distributions are a multiple of the dividend for the voting instrument, that is specified at issuance either contractually or statutorily, meaning that distributions must be equal to the dividend on the voting instruments multiplied by a parameter and that multiple cannot be changed. For instance, the distribution could always be equal to 120% of the dividend on the voting instrument. **Under these draft RTS, the differentiated distributions instruments joint stock institutions will be allowed to include in Common Equity Tier 1 will only be of that type.**

That type of rule caps the remuneration of the instrument, while caps are normally prohibited for the Common Equity Tier 1 (CET1) instruments of joint stock companies by point h (iii) of Article 28. However, multiple dividends are not considered caps if they comply with Article 28(.3).

This draft RTS suggests that the conditions to comply are that the multiple is not more than 125%(rule 1 in the explanatory table below), but also that the total amount of the distributions paid on all Common Equity Tier 1 instruments during a one year period does not exceed 105% of the amount that would have been paid if non-voting instruments received the same distributions as voting instruments”(rule 2 in the explanatory table below).

This second rule is to make sure that the drag on own funds is not disproportionate in aggregate terms, that is, compared to the total Common Equity Tier 1. In other terms, the rule makes sure that the distributions on the total of instruments with multiple dividends do not create a disproportionate drag compared to a situation where those instruments would be paid with the same distributions as the voting instruments.

Those two rules interact since the first rule limits remuneration of a single dividend multiple instrument and the second one limits the distributions of the whole class of those instruments. It follows that the simultaneous application of the two rules impacts the number of instruments with a dividend multiple that may be issued.

In order to illustrate, a few examples follow:

Where

$k$  represents the amount of the distribution on one instrument without a dividend multiple;

$l$  represents the amount of the distribution on one instrument with a dividend multiple;

$X$  represents the number of voting instruments;

$Y$  represents the number of non-voting instruments;

The parameter for rule 1 is the multiple as chosen in the contract or statutory terms relative to the non-voting instrument

The parameter for rule 2 is 105% of the amount that would have been paid if non-voting instruments received the same distributions as voting instruments.

Case 1: There are 100 instruments without a dividend multiple, and the distribution on each of those instruments is 10. The institution has chosen to issue instruments with a dividend multiple of 125%. The distributions on each of those instruments will therefore be 12.5.

The institution has to make sure that the total distributions are not in excess of 105% of the amount that would have been paid if non-voting instruments received the same distributions as voting instruments. The total distributions are 1312.5, to be compared with the 1250 which would have been paid if non-voting instruments received the same distributions as voting instruments: the proportion is exactly 105%.

Given the value of the multiple, instruments with a dividend multiple can represent at most 20% of total Common Equity Tier 1.

In case 2, the multiple chosen is lower and the institution can issue more instruments with a dividend multiple and still comply with rule 2.

In case 3, the institution chose to issue less than the maximum amount of instruments with a dividend multiple that was possible under the combination of rules 1 and 2.

	Case 1	Case 2	Case 3
Number of instruments without a dividend multiple (X)	100	100	100
Number of instruments with a dividend multiple(Y)	25	100	10
Number of CET1 instruments (X+Y)	125	200	110
distribution on one instrument without a dividend multiple(k)	10	10	10

Parameter for rule 1 (maximum: 125%)	125	110	125
	%	%	%
distribution on one instrument with a dividend multiple(I)	12.5	11.0	12.5
Value of the distribution on all voting instruments (kX)	1000	100	100
		0	0
Value of the distribution on all non-voting instruments (IV)	312.	110	125
	5	0	
Total distributions	1312	210	112
	.5	0	5
maximum number of instruments with multiples relative to instruments without multiples given the parameters for rule 1 and 2	25	100	25
Total distributions compared to the amount that would have been paid if non-voting instruments received the same distributions as voting instruments	105	105	102
	%	%	%
Proportion of dividend multiple instruments to total CET1	20%	50%	9%

QUESTIONS FOR CONSULTATION:

Q1: How do you assess the suggested limits of 125% under Article 7b (1)(a) and 105% under Article 7b(1)(b) for joint stock companies (or non-joint stock companies, where applicable)?

Q2: How do you assess the proposal to disqualify all dividend multiple instruments when the 105% limit is breached, for joint stock companies or non-joint stock companies, where applicable? In which circumstances would this limit not work or be breached without the institution being able to prevent this breach?

HAS ADOPTED THIS REGULATION:

*Article 1*

**Amendments to Regulation xx/xxx** [EBA draft RTS on Own Funds submitted in the summer]

Regulation (EU) No xx/xxxx [EBA draft RTS on Own Funds submitted in the summer] is amended as follows:

1. The following Articles 7b and 7c are inserted after Article 7:

.....

*Article 7b*

*Whether and when multiple distributions would constitute a disproportionate drag on own funds*

*(Legal basis: Article 28(5b) of Regulation (EU) No 575/2013)*

- 
1. Distributions on Common Equity Tier 1 instruments referred to in Article 28 of Regulation (EU) No 575/2013 shall be deemed not to constitute a disproportionate drag on capital if both of the following conditions are met:

(a) The amount of the distribution on one instrument with a dividend multiple does not represent more than 125% of the amount of the distribution on one voting Common Equity Tier 1 instrument.

In formulaic form this would be expressed as:

$$l \leq 1.25 \times k$$

where:

$k$  represents the amount of the distribution on one instrument without a dividend multiple;

$l$  represents the amount of the distribution on one instrument with a dividend multiple;

(b) The total amount of the distributions paid on all Common Equity Tier 1 instruments during a one year period does not exceed 105% of the amount that would have been paid if instruments with fewer or no voting rights received the same distributions as voting instruments.

In formulaic form this would be expressed as:

$$kX + lY \leq (1.05) \times k \times (X + Y)$$

where:

$k$  represents the amount of the distribution on one instrument without a dividend multiple;

$l$  represents the amount of the distribution on one instrument with a dividend multiple;

$X$  represents the number of voting instruments;

$Y$  represents the number of non-voting instruments;

applied on a one- year basis.

2. For the purposes of paragraph (1):
- a) The dividend multiple shall be a multiple of the distribution paid on the voting instruments and not a predetermined fixed amount;
  - b) The dividend multiple shall be set contractually or under the statutes of the institution;
  - c) The dividend multiple shall not be revisable;
  - d) The same dividend multiple shall apply to all instruments with a dividend multiple.

- 
3. Where the conditions of paragraphs 1 and 2 are not met, all outstanding instruments with a dividend multiple shall be disqualified from Common Equity Tier 1 capital.

**Explanatory box:**

**Approach retained for non-joint stock companies**

For non-joint institutions, the draft RTS would allow the issuance of instruments with differentiated distributions that are not predetermined multiple distribution instruments. The rules would be applied on the basis of several tests and conditions as described below.

**Test 1: Is there a predetermined dividend multiple contractually or statutorily set for the non-voting instruments which grants a higher dividend to non-voting shares?**

Setting a multiple is not the common practice in the non-joint stock sector and may create a drag on capital in reducing the flexibility of payment. In this case, the rules for predetermined multiple distribution instruments laid down above would apply.

**Test 2: under the statutes or national applicable law, may the non-voting shares only be subscribed and held by holders of voting shares? In addition, does the institution either apply the principle of one man/one vote, or there is a limit on the number of voting shares that may be purchased by each shareholder?**

If this test is met, in practice voting rights and distributions are disconnected under the statutes of the institution and therefore, there is no clear link between the distributions and the absence of voting rights. The rationale for limiting the distributions on the non-voting instruments in the case of joint stock companies to an amount proportionate to the loss of the voting right disappears. Furthermore, if there are some limitations to the ability to hold voting shares, it would be difficult to recapitalise with the voting instrument only.

If the test is met, the following additional conditions will apply to make sure there is no risk of a drag on own funds. In the absence of such a risk, the limits applying for joint stock companies will be waived:

*Condition 1:* The dividend for voting shares is below market rates compared to similar instruments to the satisfaction of competent authorities, over the last 5 years.

*Condition 2:* The dividend payout ratio calculated taking into account both voting and non-voting instruments is deemed to be sufficiently low to not impose a disproportionate drag on capital. This condition will notably be deemed to be fulfilled if the dividend payout ratio was under 30% of total profits on average over the last 5 years.

**Test 3: if the test 2 is not met, is the distribution on voting shares subject or not to a legal cap under applicable national law?**

If the distribution on voting shares is limited by a legal cap, it may be argued that the limit of 125% applicable to joint stock is not appropriate, because imposing this limit would reduce the ability of these institutions to issue capital instrument even if there is a need for recapitalisation. Only a cap

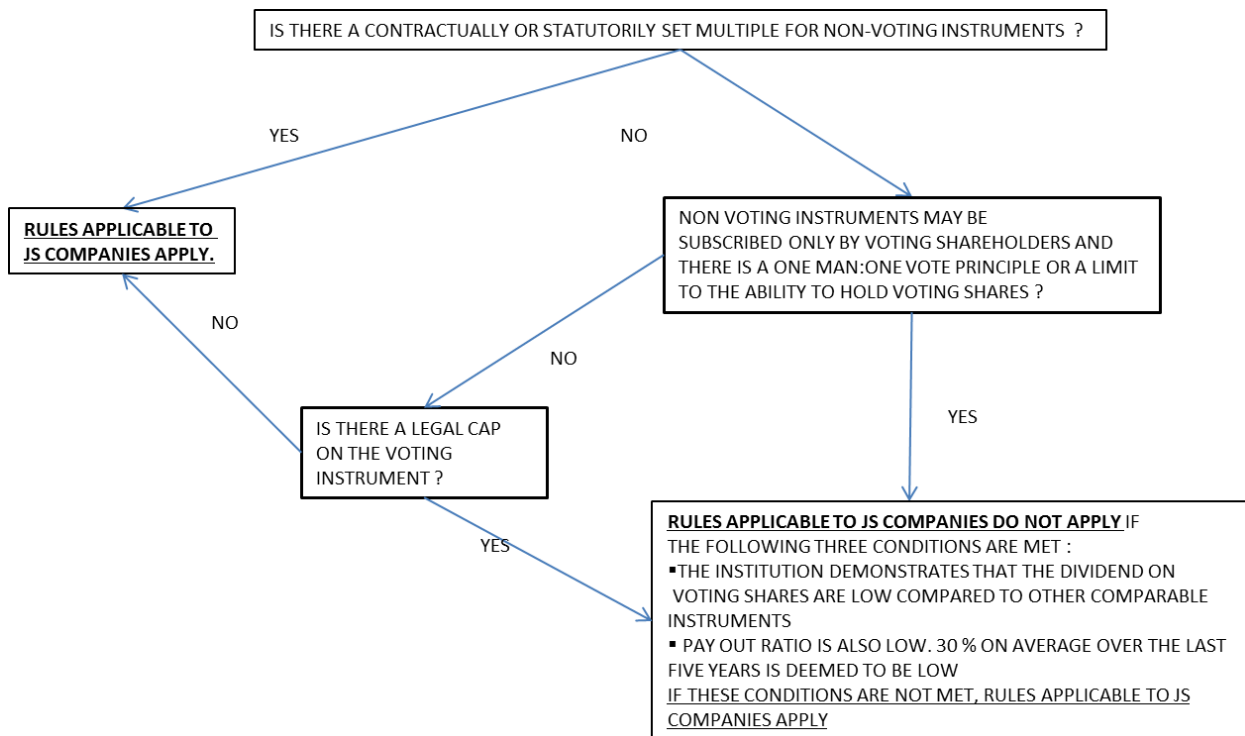


externally set (by national applicable law) would really be binding for institutions since statutory caps may always be changed.

If the distribution on voting shares is subject to a legal cap, and subject to the three conditions outlined above being met, the limits applicable to joint stock companies will not apply.

If the distribution on voting shares is not subject to a legal cap and the test 2 is not met, the limits applicable to non-voting shares issued by joint stock companies apply.

**Summary decision tree diagram:**



**QUESTIONS FOR CONSULTATION:**

Q3: Is the application of the different tests clear? How do you assess the approach retained for non-joint stock companies?

Q4:How do you assess the applicability of the conditions in paragraph 2?

Q5: Is the chosen approach applicable to all instruments that may be issued by non-joint stock institutions?

Q6: How do you assess the proposed levels of 30% for the payout ratio in paragraph 5(d) of Article 7b?

Q7: please provide data on the distributions on instruments as well as possible references to be used as benchmarks for the distributions on voting instruments issued by non-joint stock companies. How would you assess that distributions on voting instruments issued by non-joint stock companies are low? Can you suggest a methodology?

- 
4. For Common Equity Tier 1 instruments with fewer or no voting rights issued by institutions referred to in Articles 3 to 6 of this Regulation [*to be understood as draft RTS on own funds EBA/RTS/2013/01 as published on the EBA website*], paragraphs 1, 2 and 3 shall not apply in the cases described in paragraph 5 or paragraph 6.
  5. The following conditions apply simultaneously:
    - (a) The instrument with fewer or no voting rights may only be subscribed and held by the holders of voting instruments;
    - (b) The number of the voting rights of any single holder is limited, either because each holder only receives one voting right irrespective of the number of voting instruments he holds, or because the number of voting instruments any holder may hold is limited under the statutes of the institution or under applicable national law;
    - (c) The average of the distributions on voting instruments during the preceding five years, is low in relation to other comparable instruments;
    - (d) The institution demonstrates to the satisfaction of the competent authority that the payout ratio is low; any payout ratio under 30% shall be deemed to be low;
    - (e) The distribution on the instrument with fewer or no voting rights is not a multiple of the distribution on the voting instruments that is set contractually or statutorily.
  6. The distributions on the voting instruments issued by the institutions are subject to a cap set out under applicable national law and conditions c), d), and e) of paragraph 5 are met.
  7. For the purposes of point (d) of paragraph 5, the payout ratio shall be the sum of distributions related to total Common Equity Tier 1 instruments over the previous five year periods, divided by the sum of profits related to the last five year periods.
  8. For the purposes of this Article, the one year period shall be deemed to end on the date of the last financial statements of the institutions.
  9. Institutions shall assess the compliance with the conditions in paragraph 5 and 6, and inform the competent authority on the result of their assessment, at least in the following situations:
    - (a) Every time a decision on the amount of distributions on Common Equity Tier 1 instruments is taken;
    - (b) Every time new Common Equity Tier 1 instruments with fewer or no voting rights are issued.
  10. Points (a) and (d) of paragraph 5 shall not apply under recapitalisations or other emergency situations.

---

*Article 7c*

*On the meaning of preferential distributions*

*(Legal basis: Article 28(5c) of Regulation (EU) No 575/2013)*

For the purposes of Article 28 of Regulation (EU) No 575/2013, a distribution on a Common Equity Tier 1 instrument shall be deemed to be preferential relative to other Common Equity Tier 1 instruments where at least one of the following conditions is met:

- (a) distributions are decided at different times;
- (b) distributions are paid at different times;
- (c) there is an obligation on the issuer to pay the distributions on one type of Common Equity Tier 1 instruments before paying the distributions on another type of Common Equity Tier 1 instruments;
- (d) a distribution is paid on some Common Equity Tier 1 instruments but not on others, unless the condition of paragraph 5 (a) of Article 7b is met;
- (e) there are differentiated levels of distributions, unless where the conditions of Articles 7b are met.

*Article 2*

**Entry into force**

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

*For the Commission*  
*The President*

*[For the Commission*  
*On behalf of the President*

*[Position]*

---

## 5. Accompanying documents

### 5.1 Draft cost–benefit analysis/impact assessment

#### 5.1.1 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.

#### 5.1.2 Problem definition and objectives of the regulatory technical standards

*Issues identified by the European Commission 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**<sup>6</sup>.
  - 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 particularly 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.
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<sup>7</sup>.

---

<sup>6</sup> Cf. the impact assessment accompanying the CRR:

[http://ec.europa.eu/internal\\_market/bank/docs/regcapital/CRD4\\_reform/IA\\_regulation\\_en.pdf](http://ec.europa.eu/internal_market/bank/docs/regcapital/CRD4_reform/IA_regulation_en.pdf)

<sup>7</sup> See policy option 3.5 in the ‘Eligibility of capital instruments and application of regulatory adjustments’ section of the impact assessment accompanying the CRR.

---

### *Issues addressed by the RTS and objectives*

6. As reflected by the double mandate behind the draft RTS, the proposed regulation addresses the problem of CET1's insufficient features of loss absorption, permanence and flexibility of payments (see problem driver (i) and operational objective A in previous section) in two respects.
  - a) The disproportionate drag on capital potentially stemming from *multiple dividend* distribution rules.
  - b) The preferential nature of some forms of dividend distribution.
7. In relation to (a), the CRR establishes that multiple dividend distribution rules do not represent a breach of the CRR provisions that exclude caps, and/or other types of restrictions on the maximum level of distributions, from the conditions governing eligible CET1 capital instruments (Article 26(h)[iii]). However, the CRR only allows multiple dividend rules to be compatible with CET1 eligibility features when they do result in a disproportionate drag on CET1 capital. Article 26(3) of the CRR gives the mandate to the EBA of defining whether and when multiple dividend distribution rules constitute a disproportionate drag on institutions' CET1 capital.
8. In relation to (b), the CRR provides that preferential distributions of dividends are not compatible with CET1 eligibility and gives the mandate to the EBA of defining the meaning of such preferential distributions.

#### 5.1.3 Baseline current regulatory framework and market practices

9. National Supervisory Authorities (NSAs) were asked to provide evidence on the existence of both differentiated distributions and multiple dividend distributions in their respective jurisdictions. Feedback was received from 21 NSAs<sup>8</sup>, showing that differentiated distributions exist in 7 out of 21 jurisdictions and multiple dividend rules exist in 4 jurisdictions.
10. Two of the NSAs that do not currently report cases of differentiated or multiple dividend distributions expect issuances of instruments with that type of distribution once the CRR comes into force.

#### 1.1.2 Considered approaches and expected impact of the proposals

11. For the purposes of these draft RTS, the disproportionate drag on capital, potentially stemming from multiple dividend rules, is considered to be an excessive distribution of dividends that is likely to undermine the capitalisation of institutions and, hence, their loss-absorbency capacity.

### *Different rules for joint stock and non-joint stock companies*

12. **Proposal 1:** the RTS introduce different limits on the issuance of non-voting shares on joint stock companies versus NJS companies.
13. In the case of joint stock companies, ordinary voting instruments are the most flexible instruments that an institution may use to increase equity. Those instruments are permanent, characterised by a fully flexible dividend and, where needed, can be made more attractive to new investors by, for instance, decreasing the issue price and increasing dilution without needing to increase the

---

<sup>8</sup>The 21 jurisdictions covered are: AT, BE, BG, CZ, DE, DK, EL, ES, FI, FR, HU, IE, IT, NL, NO, PL, PT, RO, SE, SL, UK.

---

dividend pay-out. One of the main reasons for joint stock companies to issue non-voting shares is to protect the voting rights of existing shareholders. Although this is a justifiable business and has strategic benefit to the firm, it has to be weighed from a prudential perspective against the risk (i.e. the cost) of disproportionate drag on capital that may arise from multiple dividend rules associated with non-voting shares.

14. Following from these considerations, and considering the possibility for joint stock companies to raise capital through the issuance of ordinary voting shares, the RTS propose stricter conditions around the issuance of non-voting shares with multiple dividends on joint stock institutions.
15. In the case of NJS institutions, and in particular cooperatives, ordinary voting shares are generally issued at par and the shareholders' return is generally limited to the dividend payment (no access to reserve in liquidation, redemption at par and no dilution effect when new shares are issued, no possibility to sell). In addition, the dividend payment on the voting shares may be subject to a cap. As a result, the ability of cooperative institutions to raise capital through the issue of voting shares is more limited than the same ability of joint stock institutions.
16. In addition, most NJS companies apply the principle of 'one man, one vote'. When the non-voting shares may be subscribed only by holders of voting shares, issuing non-voting shares will not influence the level of voting rights. When shareholders have the flexibility to decide on the dividend to be paid on voting and non-voting shares, the situation (in terms of dividend payment) where the shareholder subscribes one voting share and several non-voting shares will be the same as the situation where the shareholder subscribes several voting shares.
17. In order to avoid a disproportionate impact on the capability of cooperatives to issue capital instruments, when needed, the draft RTS propose a different regulatory treatment for cooperatives.

#### *Treatment for joint stock companies*

18. **Proposal 2:** the draft RTS propose to set a double limitation on the dividends that can be distributed whenever a multiple dividend rule is applied, as follows:
  - a) **RULE 1:** a first rule establishes a cap on the factor used to define the multiple dividend rule itself. Defining A as the share whose remuneration constitutes the benchmark (base) of the multiple dividend rule and B as the share subject to the multiple dividend distribution rule itself, RULE 1 establishes that share B can be distributed at most at 125% of the nominal amount of dividends distributed to share A.
  - b) **RULE 2:** a second rule establishes a cap on the relative (percentage) difference between the aggregate nominal amount of dividends distributed when the multiple dividend is used and the aggregate nominal amount of dividends that would be distributed, to the same total number of shares, in the event that an identical amount of dividend was distributed to both share A and share B. The total distribution under the multiple dividend rule can be at most 5 % greater than the total distribution that would be granted to the same total number of instruments in the absence of a multiple dividend rule.
19. The proposed cap on the coefficient of multiple distributions is, according to available evidence, in line with the maximum coefficient implemented in one of the few jurisdictions where multiple dividend rules are currently being applied. In addition, the value proposed of 125% is not incompatible with the dividend premium, estimated in the academic literature that the markets pay

---

on non-voting shares. Instruments with diminished voting rights are the only ones that, in accordance with the CRR, can be subject to differentiated dividend distribution.

*Differentiated treatment for different models of non-joint stock companies*

20. **Proposal 3:** the RTS propose to treat NJS companies differently in the following cases:
- a) when non-voting instruments may be purchased only by holders of the voting instruments (case A) or could be purchased by a third party (case B);
  - b) when a cap exists on voting instruments.
21. **Case A:** the draft RTS propose that no regulatory limit is necessary. In this case, all non-voting holders also hold voting instruments. Holders of non-voting instruments by definition all have a voting right, since they also own a voting instrument. The notion of deprivation of a voting right that should be compensated cannot be applied this case. In practice, in this situation the voting right and the distribution of the same holder are split between two instruments. However, it is still necessary to assess the overall level of distributions. Therefore, the institution must demonstrate to the competent authority that both the distribution on voting instruments and the pay-out ratio for CET1 instruments are low in order for the limit not to apply.
22. **Case B:** when the voting instrument is capped under applicable national law, the assumption is that the distributions on the voting instrument will be low and therefore the limit suggested for joint stock companies would not be appropriate. The limit will not be applied, provided that the institution demonstrates to the competent authority that both the distribution on voting instruments and the pay-out ratio for CET1 instruments are low.

---

## 5.2 Overview of questions for consultation

Q1: How do you assess the suggested limits of 125% under Article 7b (1)(a) and 105% under Article 7b(1)(b) for joint stock companies (or non-joint stock companies, where applicable)?

Q2: How do you assess the proposal to disqualify all dividend multiple instruments when the 105% limit is breached, for joint stock companies or non-joint stock companies, where applicable? In which circumstances would this limit not work or be breached without the institution being able to prevent this breach?

Q3: Is the application of the different tests clear? How do you assess the approach retained for non-joint stock companies?

Q4: How do you assess the applicability of the conditions in paragraph 2?

Q5: Is the chosen approach applicable to all instruments that may be issued by non-joint stock institutions?

Q6: How do you assess the proposed levels of 30% for the payout ratio in paragraph 5(d) of Article 7b?

Q7: please provide data on the distributions on instruments as well as possible references to be used as benchmarks for the distributions on voting instruments issued by non-joint stock companies. How would you assess that distributions on voting instruments issued by non-joint stock companies are low? Can you suggest a methodology?