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## THE CHAIRPERSON

Michel Barnier  
Internal Market and Services  
European Commission  
Rue de la loi  
1048 Brussels  
Belgium

21 November 2012

EBA/Op/2012/04

Dear Commissioner Barnier

In the conduct of the recapitalisation exercise of 2011, the EBA observed serious discrepancies in the application of transitional floors to capital requirements. Neither the draft proposal of the Commission for the Capital Requirements Regulation (CRR), nor the subsequent proposals by the Council and the European Parliament address the issues we have identified and achieve the necessary harmonisation.

Currently, different methodologies are used for calculating the transitional floors. In particular, in some jurisdictions the floor is based on minimum own funds (capital requirements), while in others the focus is on total own funds. The likelihood that the floor generates a restrictive effect on the regulatory ratio reported and disclosed by institutions is much lower under the latter approach.

The EBA conducted an analysis of the impact of the differences in the calculation of floors, on the basis of the limited evidence available. The results are deeply unsettling. If all banks were requested to apply the more conservative approach, additional capital of up to EUR 40 bn would be needed to maintain capital ratios at the current level, in line with the recommendation issued by the EBA in December 2011. Conversely, if all banks were to rely on the alternative approach, up to EUR 5 bn of regulatory capital could be released.

The Board of Supervisors of the EBA discussed the matter at length, concluding that the lack of harmonization in the calculation of the floor poses a serious level playing field issue, which should be addressed as a matter of urgency. Moreover, at a time when concerns about the quality of bank assets cast doubt on the calculation of risk weighted assets, a reliable, harmonized backstop in the form of a capital floor would be beneficial in reassuring market participants regarding the reliability of the regulatory benchmarks.

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The EBA considers that a consistent methodology for the calculation of the floor should be based on the standardised approach in force, and not on an older set of regulations. It should thus rely on the standardised approach as defined in the CRR rather than on risk weighted assets calculated according to the Basel 1 framework.

However, more work is needed in order to fine tune the common approach to be used and discussions about the objective and the methodology for the calculation of the floors are also taking place at the international level. Therefore, conscious of the tight deadline for the finalisation of the CRR text, the EBA advises that amendments to the legislative text be introduced, so as to achieve an explicitly defined and harmonised floor. The changes in Article 476 would be the following:

- the text should remain neutral as to the choice between the two approaches, allowing the EBA to make a proposal based on a rigorous supervisory analysis;
- the floor would be calculated on the basis of the standardised approach of CRR (not on the basis of Basel 1);
- the EBA would be mandated to draft a regulatory technical standard that specifies a single methodology for the calculation of the floor;
- the EBA would be asked to review the application of the floors two years after the entry into force of the CRR and to report to the Commission on the continued need for the floor, in light of alternative supervisory and regulatory safeguards.

Yours sincerely

*(signed)*

Andrea Enria

Copy sent to:

Mr Othmar Karas, Member of the European Parliament

Mr Constantinos Trikoupis, Councillor, Financial Services, Cyprus Presidency

Mr Jonathan Faull, Director-General, DG Internal Market and Services, European Commission