The ESBG’s response to the EBA’s consultation on draft RTS on own funds (Part IV) (EBA/CP/2013/43)

ESBG (European Savings and Retail Banking Group)

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General comments

We would like to thank you for the opportunity to submit comments on the consultation paper EBA/CP/2013/43 that we are glad to use.

Before going into the details of the questions, we would like to mention,

- That the Basel III rules do not appear to operate with similar restrictions for differentiated distributions, which are now discussed in relation to the RTS.
- That the CRD IV and CRR already contain provisions that are modeled to protect capital, including the capital conservation buffer, the countercyclical buffer, the ability to suspend interest payments on additional Tier 1 capital, as well as the determination of an individual solvency requirement as a result of the Supervisory Review And Evaluation Process.

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 (non-joint stock companies, where applicable)?

Article 25 (5) (b) requires the EBA to “(...) develop draft regulatory technical standards to specify (...) whether and when multiple distributions would constitute a disproportionate drag on own funds”.

The draft RTS gives the EBA’s definition, when multiple distributions constitute a disproportionate drag on own funds: if they are more than $\frac{1}{4}$ higher than the ones on voting common equity tier (CET) 1 instruments and if all distributions on CET1 instruments exceed 105% of the level reached if all instruments received the same distribution.

We fail to see the EBA’s point on whether multiple distributions would constitute a disproportionate drag on own funds. The EBA gives no reasoning why 25% more distribution on a non-voting instrument than on a voting instrument would constitute a disproportionate drag on own funds, nor does the EBA explain why 5% more distribution than an even distribution on all CET1 instruments would constitute such disproportionate drag on own funds.

The only reasoning provided for these limits is given in paragraph 5.1.3 (9) and (19) mentioning that the limit would be in line with the existing rules in 4 (of 28) European Member States and not be incompatible with estimates in academic literature, giving no reference.

Contrary to the EBA, we think the 125% limit is overly restrictive. We see no indication that larger distributions to non-voting CET 1 instruments would create an undue drag on the capital base. The same holds true for the 105% cap.

On the contrary, agreed multiple distributions do not affect the quality of CET 1, as long as the distribution is at the sole discretion of the issuer. Also, such a restriction would penalise banks which can only issue new voting capital instruments to a very limited extent due to their ownership structure and which must increasingly resort to non-voting instruments. The hard limits on non-voting instruments would limit the issuance of these instruments, as they would be less attractive.
Furthermore, according to recital 72 CRR, flexibility should be maintained, instead of being limited, as it is the case concerning the two limits. The interpretation of a disproportionate drag on own funds, which follows from multiple distributions, may also be explained based on the proportionality principle and prudential principles, rather than in the form of hard limits.

If the EBA’s approach to the limits was to be retained nevertheless, we consider the formulation of two conditions as too excessive. Besides a decrease in competitiveness, the condition laid down in Art. 7b (1) (a) constitutes an unnecessary excessive limitation of flexibility. The condition laid down in Art (7b) (1)(b) is sufficient to reach the objectives of these RTS.

In case an institution decides to formulate a higher dividend multiple than proposed in Art. 7b (1) (a), the maximal amount of instruments issued would correspondingly be lower. We therefore plead to dismiss the introduction of 2 quantitative limits and to only maintain the limit expressed in terms of the total amount of distribution paid on CET 1 instruments [Art. 7b (1) (b)].

We consider the specified percentage (105%) as unreasonably low and would plead to increase the percentage to 110%.

**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?**

We do not see the requirement to disqualify from CET1 all outstanding CET1 instruments with a dividend multiple if the conditions of paragraphs 1 and 2 are not met. It would even be contradicting prudential purposes, as institutions which want to have a broader capital base need to issue instruments which explicitly do not comply with CET1 requirements (for instance Tier 2 instruments or other) in order to prevent paragraph 3 from being applicable. This would lead to more different capital issuances making the capital base intransparent.

The proposal to disqualify all dividend instruments when the limit is breached is unreasonably severe. Examined in more detail, it seems that the punitive character of this proposal actually undermines the aim of preventing a disproportionate drag on capital. To prevent this paradox result, only the amount of instruments correspondingly exceeding the determined percentage should disqualify from CET1.

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

The regulatory content of the tests is mainly clear. However, we would like to question the necessity of Test 1. In our opinion, Test 2, and the last three conditions mentioned, are not applicable to certain institutions, such as institutions under public law like the German savings banks. In general, voting rights do not exist in these institutions, and thus, the required proportionality consideration between voting and non-voting instruments is not possible. Therefore, we would like to propose to adapt the standards accordingly.
Furthermore, we cannot understand, either, why the distributions on voting instruments, in relation to comparable instruments, must be low. Unfortunately, the standards provide no reasons in this respect. This condition cannot be met by certain institutions, such as those under public law, due to their lack of voting instruments.

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

Paragraph 2 refers to the conditions for joint stock companies, which have been addressed in Questions 1 and 2. Therefore, it is not clear to us why there is a reference to this paragraph again here.

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

No comments.

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

According to Article 28 (3) CRR, paying a dividend multiple is possible if such a dividend multiple does not cause a disproportionate drag on own funds. As stated by the justifications for Test 2, the 30% limit for the distributions over the last five years should prevent the disproportionate drag. This correlation is not obvious for us.

The distribution ratio of recent years is not directly or exclusively affected by a dividend multiple. Rather, it represents the conduct of distribution of the institutions. This is especially true for the first years under the CRR regime. Under certain circumstances it may be useful to limit distributions. However, the condition mentioned in Article 28 (3) CRR (no disproportionate drag) is not directly related to this in our opinion.

Furthermore, the proposed benchmark does not harmonise with other requirements in the CRR/CRD IV, such as Article 141 CRD IV which regulates the restrictions on distributions when the combined buffer requirements are not met. We think that limits should only be determined when the institution is not in compliance with the requirements in CRR/CRD IV.

In general, we are not aware of any legal justifications in the CRR/CRD IV or in the RTS to propose a benchmark for a level for a payout ratio of 30% (for all CET1 instruments).

**Q7: Please provide data on the distributions 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?**
Unfortunately, we do not have corresponding data or methods available. Nevertheless, we would like to strongly ask to consult credit institutions (again) regarding potential methods which might be considered.
About ESBG (European Savings and Retail Banking Group)

ESBG members represent one of the largest European retail banking networks, comprising of approximately one-third of the retail banking market in Europe, with total assets of over €7,300 billion, non-bank deposits of €3,480 billion and non-bank loans of €3,950 billion (31 December 2012).

ESBG members are typically savings and retail banks or associations thereof. They are often organised in decentralised networks and offer their services throughout their region. ESBG member banks have reinvested responsibly in their region for many decades and are a distinct benchmark for corporate social responsibility activities throughout Europe and the world.