



*European Association of Co-operative Banks  
Groupement Européen des Banques Coopératives  
Europäische Vereinigung der Genossenschaftsbanken*

Secretariat of the BCBS  
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**Consultation paper: Strengthening the Resilience of the Banking Sector**

Dear Sir/Madam,

The European Association of Co-operative Banks (EACB) welcomes the opportunity to comment on the Consultation paper "Strengthening the Resilience of the Banking Sector".

Please find our remarks on the following pages.

We remain at your disposal,

Yours sincerely,

Hervé Guider  
General Manager

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Head of Legal Department



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## **General Remarks**

### **1. Introduction**

The members of the EACB support the Commission's overall goal of improving the banking sector's ability to absorb shocks arising from financial and economic stress, while at the same time promoting sound credit and financial intermediation activity. Improving risk capture and the quality of the capital base, controlling excessive leverage in the financial system, addressing procyclicality in capital requirements and managing systemic risk are all goals that we endorse.

As said, we support the dual objective of improving the resilience of the global financial system and ensuring a level playing field sought by the reform package, but at the same time we think modifications will be needed to manage the tradeoffs between layers of protection on the one hand and prudent credit provision for economic growth on the other.

### **2. Economic impact**

The regulatory reform package that was decided in Pittsburgh by the G20 to reduce systemic risks and which is the rationale for this consultation is currently a key topic in the international and national debates. The main issues concern the number and the impact of these measures on the overall economy. Some members of the EACB voiced that the required strengthening of own funds and liquidity standards will most probably have a very negative effect on the national and European economy and for the evolution of the banking industry. It is considered that the only effect of the solvency requirements is that it would cause a considerable restriction of the distribution of credit. Analysts of one of our Member banks estimated that there could be a reduction of the provision of credit by 20% in the EU with a negative impact on the real GDP of approximately 1.5% on the short term and 6% in the mid to long term. The reduction in credit provision could particularly affect clients in more peril situations like SMEs.

A global asymmetric situation could arise if Basel III is in the first place not implemented and secondly not applied in the United States. This would create an uncompetitive level playing field at the global level which will most likely curb the economic growth in the European Union.

The EACB therefore considers that it is highly important to conduct an additional impact assessment to analyse the effect of the proposed reform package on the real economy on the short, medium to long term and also its impact on the international level playing field. The key message of the all policymakers worldwide and at European level to 'get it right' could not possibly mean that there should only be a strong and strengthened supervisory regime and not also a favourable banking environment. In order 'to get it right' the implications of the proposed measures must be subject to a comprehensive scrutiny to avoid a further slow down of the European economy and end up in the 'second league' behind the USA and Asia as stated by Dominique Strauss-Kahn in Bucharest on 30 March. While the members of the EACB acknowledge that it is necessary to act swiftly and in a coordinated manner, it is highly recommended to assess the impacts on the real economy in order not to assign ourselves a place at the sidelines. We therefore urge the Commission to initiate proportionate capital and liquidity measures and urge the legislators to take the possible consequences for the overall economy, for SMEs and the banks and their international level playing field carefully into consideration.



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### **3. Cumulative impact**

In the second place, the current proposals for further and additional changes to the capital requirements directive the so-called CRD IV and the sets of revisions of CRD III could as the Commission rightly recognises have a cumulative effect that might be substantial and could have implications for the amounts of funds that institutions have available to lend to businesses. We therefore welcome the initiative of the Commission to invite CEBS to carry out a European Quantitative Impact Study (QIS) to aid the assessment of the aggregate affect of the two proposed revisions.

However, we can rely on the assumption that the impact assessment exercises currently being conducted for CRD IV and III will demonstrate that the proposals, if implemented as initially proposed, will create severe economic consequences both for the financial industry and the global economy at large.

Therefore, we consider that it is necessary and essential given the considerable economic impacts of the reform package to have next to the revisions of the proposals, also a revision of their calibration, an analysis of the interdependence between the proposed measures of different CRDs, a full assessment of their overall cumulative impact on the economy, the determination of priorities, and a realistic implementation calendar before a final set of standards is issued for implementation by the financial industry.

### **4. Further consultation**

Given the fundamental nature of the proposals and the significant components that still remain to be defined, we consider that the present round of consultation should only be considered as a first step. We appreciate the G20 time plan but we would foremost like to underline that achieving the objectives and striking the right balance is the most important issue.

We would therefore like to request the Commission to conduct extensive further consultation as it revises the proposals around the summer of 2010. In that respect, we would also ask the Commission to incorporate in the assessment the impact of the introduction of the already approved CRD II (to be applied from 31 December 2010) onwards and CRD III presently under discussion in the EP and applied from 1 January 2011 onwards. We would appreciate to have next to an additional formal consultation paper on the revised proposals, also an additional QIS exercise, an additional impact assessment of the proposed measures and its effects on the real economy and a final impact assessment of all CRD proposals to be brought into circulation in parallel.

We think it is fundamental to assess all relevant changes cumulative, with full consideration of their interdependencies and their impact on the real economy in the short and long run. Moreover, it is necessary to fine tune the proposals by designing adequate grandfathering and phasing-in and phasing-out measures and time the transition to minimize the disruption of markets as to the pricing as well as the ability to meet extra demands of capital. In our opinion, this is essential for the Commission to meet its goal to "ensure that the sum of these measures does not result in banks holding excessive buffers beyond what is necessary to maintain a resilient banking sector."

### **5. Implementation related issues**

The whole proposal package is very complex and stricter rules are envisaged for capital adequacy measurement both from the side of the calculation of capital and the assessment of risks. It is very difficult to estimate the impact of the proposed changes on the activities of the credit institutions together with the modifications to the capital



adequacy framework already in course. The introduction of the CRD4 package at one point in future time may have a credit squeeze effect and may contribute to another crisis. Therefore, we suggest that it would be better if the potential measures were introduced gradually, preceded by a strict monitoring phase, and not only by a quantitative impact study. A harmonised reporting and monitoring could help to minimise the negative impacts by introducing the necessary modifications yet before gradual implementation.

Timing is therefore essential. We would like the Commission to develop shortly a clearer strategy as to the way the reforms will be implemented. A detailed implementation plan, including phasing-in and -out and further explanation of possible degrees of flexibility, will need to be developed once the proposals acquire a more definitive shape. This is all necessary under the precondition that the recovery of the financial sector and the economy as a whole are not hampered. In this regard, our present assessment is that full implementation by the end of 2012 seems excessively ambitious.

On the implementation, we would like to refer also to the so called “announcement risk” of the proposals. This is the likely immediate impact the announcement of the Commission regarding its final decisions would have on market participants and rating agencies as to their expectations of the amounts of capital that banks should hold. While market dynamics are by definition autonomous, the Commission should carefully consider this issue as it finalizes its plans for implementation.

As an example we can mention the expectations of markets and rating agencies if the Commission decides to introduce higher minimum standards for the Tier 1 ratio. The markets and rating agencies will tend to evaluate these new standards right away, while official introduction is delayed for some time or fine tuned by phasing-in rules.

Implementation of the new CRD revisions and liquidity standards should be simultaneous, symmetrical, and comparable across all major financial markets, inside and outside the EU. Proper coordination with the US is required for which using the G20 seems a good opportunity.

A final remark is that we prefer continuing to support further convergence of accounting standards as final CRD rules will undoubtedly be affected by accounting. This however, does not conflict with our more fundamental position that we expect regulatory rules to be as much as possible to be independent from the actual accounting regime; or for that matter a taxation regime. We regard the independent standard setting of regulatory rules as the superior way of rule making; any dependency on changing accounting and/or taxation rules weakens the overall concept.

## **6. Conclusion**

The members of the EACB would like the Commission to take carefully into account the economic and cumulative impact of their proposals to reform the capital framework and framework for liquidity risk standards, measurement and monitoring. The EACB would suggest to the Commission to conduct additional impact assessments which include the provisions of CRD II and III and their interdependence with CRD IV; and which focus on the effect of the measure on the real economy of the European Union. As one of members mentioned ‘the impact of the planned changes of regulation will have a crucial impact on banks and on the whole economy’. We need adequate regulations that are right in the short and long term, which will also lead to equivalent treatment of co-operatives and their central institutions to continue their business according to the co-operative business model that has proven to be resilient throughout the crisis.



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## **1. RAISING THE QUALITY, CONSISTENCY AND TRANSPARENCY OF THE CAPITAL BASE (60-109)**

### **1.1. Common Equity – Co-operative Shares**

The proposals of the Basel Committee regarding common equity are of utmost importance for cooperative banks, not only in Europe, but throughout the world.

#### **1.1.1. A case for co-operatives and mutuals**

Co-operative banks are of significant importance to the European Banking Sector: co-operative share capital amounts to more than €35 billion. It represents a lending capacity of more than €400 billion and is held by about 50 million members of co-operatives in the EU. Co-operative banks have a market share in Europe of around 20%.

Based on their specific business model, co-operative banks form an essential part of Europe's economy. As fully private entities, co-operative banks compete with commercial banks on a fair basis. The co-operative model due to its proximity to the local economy enables banks to assess with great accuracy the risk arising in particular from credits to private householders and SME's.

Co-operative banks have its specific business and governance model. Co-operative members are not capital investors who wish to gain a fast and high rate of return. They have joined an entity whose primary purpose is to provide appropriate services to them and promote their economic situation. Furthermore, co-operative banks serve their members on a long-term.

Throughout the crisis, co-operative banks had fewer losses than other banks and their business model proved to be resilient. They continued lending to SME, in some countries even increased these activities.

#### **1.1.2. Analysis of 14 Criteria**

The members of the EACB appreciate, that the Basel Committee has chosen a principle based approach for the definition of capital. However, the Basel Committee takes the shares of a joint stock company as a benchmark for assessing the features of instruments to be included as the common equity component of Tier 1 capital. Thus the 14 criteria established by the Basel Committee reproduce the picture of a share of a joint stock company.

Due to their specific business model and governance, the EACB fears that the instruments of co-operative and mutual banks would be automatically excluded from common equity. The EACB believe that co-operative instruments (such as cooperative shares and certificates) should be eligible as core tier one capital as it is for ordinary shares.

As stated below, some of the 14 criteria are excluding co-operative shares such as claims to net assets, or redemption, that if relevant for joint-stock companies, are not relevant for cooperative banks. Therefore they should not be applied to the cooperative instruments.

#### **Access to net assets/Loss absorption**

The criteria 2, 6 (regarding the cap), 7 (second sentence), 8 (first sentence), are based on the presumption that the holder has a claim to a share of the assets of the entity and



that he is entitled to a percentage of the assets of the entity that remain after all higher priority claims have been satisfied. Thus in a joint stock company only those instruments qualify, which bear the ultimate risk and which are entitled to the ultimate rewards inherent in the entity and its activities. Admittedly, without such instruments and their holders the entity could not exist. This excludes other claimants to the entity's assets, even if they bear risks and are entitled to rewards. However, the latter may be considered to be at least partially protected from risk by common equity instruments, and their share of the rewards is limited. Especially from the perspective of criterion 2, which takes the perspective of shareholders, any claim that is senior to common equity is potentially dilutive of the residual that would otherwise be attributable to common equity.

Thus, the intention of criterion 2 is not to ensure loss-absorption<sup>1</sup>, but rather to make the definition of capital as narrow as possible in order to exclude, *in a joint stock company*, any other instrument from common equity, especially sophisticated hybrid instruments.

- However such criteria lead to inappropriate results when the business purpose and governance of an undertaking are different to those of a joint stock company. Also a co-operative bank could not exist without its shareholders, whose economic interest it has to promote. However, "the ultimate reward" inherent in a co-operative is not maximum profit, but rather the provision of a maximum of usefulness to its members, while ensuring the existence of the undertaking beyond the participation of individual members. While co-operative capital and reserves are paid in and are available to cover losses, reserves (retained earnings) in a co-operative are normally fully (sometimes only in part) indivisible: at least as long as the co-operative is going concern, if not also in liquidation, members do not have access to reserves. Members/shareholders have renounced their access to net assets in order to ensure the proper functioning of the co-operative beyond their capital involvement. Nevertheless, retained earnings are fully available for the business of the co-operative. They even form a kind of capital, exclusively dedicated to the purpose of the business. Since neither members nor anybody else has access to net assets (retained earnings), those funds are ultimately dedicated to the common business purpose until liquidation.
- Other claimants to the entity's assets are protected from risk by co-operative shares and capital as much as in a joint stock company: from a legal perspective, there is absolutely no difference between the impact of losses on capital and retained earnings in a co-operative and a joint stock company<sup>2</sup>.
- This makes evident that the Basel Committee takes a "shareholder (or ownership) perspective"<sup>3</sup> rather than a "creditor perspective" when it comes to loss-absorption. From a creditor perspective, the decisive question regarding capital is whether it can fulfil the function as risk capital "*providing a buffer, a cushion for the entity in terms of variances in its performance*"<sup>4</sup>. In a similar way, from a prudential perspective, the key aspect of loss absorbency on a going concern

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<sup>1</sup> Where available, it is always the reserves that take the first losses, not the instrument. According to 57 b) reserves is a separate element of common equity anyway.

<sup>2</sup> This shows that criterion 8 rather intends to ensure the allocation of reserves to the shareholder.

<sup>3</sup> See also FASB, Preliminary Views - Financial Instruments with Characteristics of Equity November 30, 2007, p. 5, [http://www.fasb.org/pv\\_liab\\_and\\_equity.pdf](http://www.fasb.org/pv_liab_and_equity.pdf)

<sup>4</sup> EFRAG et al: Pro-active Accounting Activities in Europe; Discussion Paper: Distinguishing between Liabilities and Equity, January 2008, page 46.



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basis should mean *"that an institution is able to incur a loss but remain solvent and viable, even if distributable reserves have already been depleted"*<sup>5</sup>.

### **Flexibility of payments**

We equally doubt that the prohibition of any caps related to the payment on the instruments, as stipulated under criterion 5 is appropriate for co-operative banks.

There is no evidence that any such cap is viewed by the market as an obligation to pay such capped amount. The evidence available on caps regarding dividends on co-operative shares in some Member States rather proves the opposite: during the last ten years, the dividend payments of co-operative banks in relevant jurisdictions were always significantly below the relevant cap, which differs from jurisdiction to jurisdiction. In addition, there is no correlation between the development of that cap and the dividends paid.

Besides, we do not see the prudential rationale of the prohibition of caps. To the contrary, we believe that such a cap can even have very positive effects, since earnings are retained and the capital base can be strengthened.

### **Permanence and "Redeemability" of Co-operative Shares**

The permanence criteria 3 and 4 are equally based on the situation of joint stock companies, while ignoring realities regarding co-operative banks. They create problems, both for co-operative shares of the IFRIC 2-type and for the classic. In fact, the redeemability of shares is a specific co-operative element, linked to the specific governance and business model of a co-operative.

Due to the principle of "open membership", normally any citizen may decide to become a member, use the services of a co-operative, but also leave the co-operative at any time. In Europe, redemptions of member shares in any year average about 1% of outstanding shares. At the same time, the overall amount of subscribed capital remained stable or is even increasing.

However, there are many mechanisms in different Member States to ensure that the capital basis remains stable and thus a permanence of capital is ensured.

In fact, the bank's obligation to make payments is subject to numerous regulatory restrictions. All in all two models can be distinguished.

In those co-operative banks that are subject to IFRS, the co-operative or its board have the unconditional right to decline requests for redemption. Following the adoption of IFRIC 2, many jurisdictions have implemented changes to their co-operative laws and thus provide for:

- Possibilities for an unconditional refusal of the redemption of shares (IFRIC 2 option 1)
- Or for introducing a level below which capital must not fall due to redemption (IFRIC 2 option 2)

In some jurisdictions combinations of both elements exist.

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<sup>5</sup> See CEBS Implementation Guidelines for Hybrid Instruments, para. 96.



In other co-operative banks, especially those that are not subject to IFRS, there are normally many elements that make redemption a very heavy process:

- The request for redemption has to be presented within a delay. Payments will only take place at the end of the business year after the approval of accounts and the distribution of profits by the general assembly.
- National law or the bank's statute may require postponing the payments even for a longer period.
- Members remain liable for losses for several years after their reimbursement.
- In case of resignation members maximally receive the face value of their member shares and leaving members may lose their right to do business with the cooperative. Therefore there are barely any inducements for members of cooperatives to resign.
- Very often the above restrictions are supplemented with supervisor's powers to limit or exclude the redemption due to capital or solvency requirements.

Thus, there are sufficient mechanisms to ensure a stable capital base.

In addition, member shares do not possess any features which could cause the condition of the institution to be weakened as a going concern during periods of market stress.

Even throughout the most severe moments of the recent crisis, the capital bases of co-operative banks remained stable. Thus, co-operative shares have to be considered equivalent to the situation of joint stock companies regarding criteria 3 and 4.

### **Other Elements**

In addition, member shares do not possess any features which could cause the condition of the institution to be weakened as a going concern during periods of market stress.

#### **1.1.3. Footnote 19 and the paragraph 74 of the Consultative Document**

Due to the above explained specific features of co-operative shares, the EACB highly appreciates that the Basel Committee has introduced footnote 19 in order to indicate that the 14 criteria may be applied in an appropriate manner to co-operative banks. The footnote should give relevant supervisors sufficient room for applying the 14 criteria to co-operative banks in an appropriate way. In our opinion certain of the above mentioned list of 14 criteria are therefore not appropriate for cooperative banks, as is demonstrated above. Based on the footnote, relevant supervisors have ample guidance for proper application of the 14 criteria to cooperative banks.

We therefore suggest maintaining the substance of the footnote as it stands. However we would suggest making the footnote a part of the full text.

While the footnote seems to provide clear guidance as regards co-operative banks and mutuals, we nevertheless see that it is somewhat in contradiction with certain passages of the text of the document. Especially the second sentence of paragraph 74 states: *"These entry criteria will also be used to identify instruments of equivalent quality which non joint stock companies, such as mutuals and cooperatives, can include in the predominant form of Tier 1 capital"*. This statement seems to be in conflict with the footnote and potentially becomes a source of misunderstandings. We therefore suggest making the document more convergent by simply adding a short element from the footnote to the sentence in paragraph 74:





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*“These entry criteria will also be used to identify instruments of equivalent quality which non joint stock companies, such as mutuals and cooperatives, can include in the predominant form of Tier 1 capital, **while taking into account their specific constitution and legal structure.**”*

## **1.2. The Possibility to have additional common equity instruments.**

The EACB believes that the possibility should remain for all banks to issue, apart from their “prime tier 1 instruments”, other financial instruments as common equity. In many jurisdictions company law allows entities to issue more than one type of “capital instruments” and that such concepts have worked well in the past. The existence of different categories of instruments should not be prohibited, especially when the prudential rationale of such a prohibition is not evident.

In particular, banks should have the option to issue without problems non-voting stock. Furthermore, we recommend to carefully examine whether the exclusion of “preferential rights” as stipulated in the 14 criteria (only) refers to the rank of payments or also to the amount.

With regard to principle 5 we do not see a reason why fixed coupons, at least of indicative character should exclude the common equity quality, as long as full discretion of the company on payments is ensured.

## **1.3. UK Co-operatives**

Special consideration has to be given to the fact that in some countries, like the UK, it is not possible for a co-operative (or certain other types of mutual) to operate a banking business other than through a joint stock company subsidiary (i.e. a non-mutual company), with the group as a whole run along mutual principles. Such banks should be able to issue instruments with limited voting-rights as core tier 1 capital to external investors in order to preserve mutual/co-operative credentials.

In this context, the national supervisors in applying the 14 criteria should have explicit discretion to recognise the fact that shares held by the mutual/co-operative group in the bank fulfil a different function (including control rights) compared to external investments with limited voting rights.

## **1.4 Limits**

The consultation paper maintains the principle that “the predominant form of Tier 1 must be its common equity component” (para 82). In a side-letter to the G-20 summit the Financial Stability Board had suggested a range between 50 and 85%. However, the qualitative requirements both for common equity and additional going concern capital will increase in a significant way. Otherwise non-listed credit institutions that do not have access to capital markets, would be put at a disadvantage. For them additional going concern capital very often is the only way to increase Tier 1 capital.

## **1.5. Regulatory adjustments applied to regulatory capital**

We broadly support the harmonization of the regulatory adjustments (“prudential filters”). However, the proposal that common equity would serve as a basis for all deductions needs to be challenged. Today, in contrast, deductions are generally applied to total Tier 1 capital or to a combination of Tier 1 and Tier 2 on a 50/50 basis.



At least it would be appropriate if the deduction is applied to the entire tier1 capital as opposed to the core tier 1 capital only. Because concerning loss absorbency there is no difference between core tier 1 and tier 1 capital.

Below our thoughts are stated on the proposed regulatory adjustments.

### **1.5.1. Minority interest**

#### **General Remarks**

A deduction of minority interest from the common equity component of Tier 1 capital will have a very negative impact on the composition and capitalization of central institutions within a cooperative banking network since it represents an important change with respect to the current regulation. The overall effect of minority deductions should be properly assessed in the impact assessment as well as possible alternative approaches to this measure.

From our point of view there are several arguments against the deduction of minority interest:

- The minority interest has the same quality and loss absorbency capacity as majority interest. As capital from the minority interest is controlled by the majority that means that it absorbs losses on a going concern basis.
- It represents an inefficient and simplistic answer to prevent abusive constructions of capital.
- The argument that minority interest can be shifted from one group to another is not enough. Capital cannot be shifted between subsidiaries but the consolidation of minority interest might allow the central institution to liberate capital that can be made available for another subsidiary in case it is needed.
- The deduction is not in line with the accounting perspective where minority interest is regarded as common equity if they fulfill the conditions to be considered as such.
- It would lead to disequilibrium between the consolidation approach and the solo approach.
- We do not think it is fair to remove minority interest from the common equity and requiring at the same time to still have to support 100% of the RWA of the subsidiary. We do not support the mismatch between the capital consolidation on the one hand and the risk consolidation on the other hand.

The allocation of minority interest as additional going concern capital is not enough because the market takes as a general parameter the common equity element of Tier 1 capital to assess the solvency of an institution. Most importantly it will be essential to permit the corresponding deduction of an appropriate amount of the subsidiary's risk weighted assets from those of the (consolidated) parent company in order to achieve symmetry. Full deduction may in many cases ignore real resources available to the group and could hinder the creation of coherent resolution plans. The current language would likewise penalize important forms of participation in emerging markets and transition economies, as banks often either choose, or are obliged by regulation, to enter foreign markets in this fashion.

In order to achieve a more balanced treatment the following options should be considered:

- To exclude RWA supported by minority interests from the denominator of the group Core Tier One ratio. For each subsidiary with minority interests, the



consolidated RWA of the subsidiary would contribute to the total group's RWA only up to the percentage held by the parent company when calculating the Core Tier One ratio of the Group. The Group core tier one ratio would then reflect in a symmetrical way both the capital held by the Group (i.e. excluding minority interests) and the risks associated with the subsidiary (i.e. excluding the portion of RWA assumed by minority shareholders)

- Another approach could also consist in the inclusion of Minority Interest up to a limit in the numerator of group core tier one ratio. There can be instances where the local subsidiary is capitalised well in excess of the Core Tier One ratio of the group measured on a consolidated basis. In this case, one could argue that the Group unduly benefits from this overcapitalisation through the inclusion of minority interests in the Group's regulatory capital.

### **The situation of decentralized co-operative groups**

Moreover, there are constellations within decentralized co-operative groups that should be looked at from a different angle when it comes to the deduction of minority interest. It would be very harmful for the central institutions of cooperative networks which have subsidiaries (e.g. leasing companies, factoring companies or companies providing ancillary services) where the minority shareholders are the members of the cooperative network, if they were deducted from capital. In these cases the minority shareholders are no external persons, but the members of the network, therefore their treatment should be different.

The EACB is aware of the Commission's objective to avoid abuses of minority interest and thus to create unsound capital structures. A possibility could be, in the context of pillar 2, that the Supervisory Authority in its duty to monitor institutions could determine an abusive use of minority interest and requires the institution to deduct it based on objective criteria.

Possible criteria to prevent abuses could be to consider:

- The relationship of the minority interest with the RWA level
- Economic background and or purpose of the subsidiary
- Economic interest of the holders of the investment
- Relationship between the external funds and liabilities

The negative effect of the proposal to simply deduct minority interest in all cases could be massive. If such adjustments are to be applied, sufficiently long transition periods must be foreseen to ensure a smooth and stable transition to the new requirements.

Further concerns to participations within decentralized groups: see 1.5.5

#### **1.5.2. Deduction of own shares**

Provision should be made for a separate market-making exception to the proposed deduction in own shares.

The requirement that gross long positions may be deducted net of short positions only if the short positions involve "no" counterparty risk is unrealistic and probably impossible to attain on a meaningful basis. Collateral and other standard risk mitigation techniques should be recognized within otherwise-applicable CRD c.q. Basel rules.



### 1.5.3. Index Securities

The requirements to look through index securities will not only be extremely difficult operationally, but it will also reduce liquidity and impair risk management by impeding trading or market-making of index securities. Active trading firms typically have balanced long and short positions, while it appears that the long but not the short would be recognized.

We suggest focusing on direct participations only. If however work on such a rule is continued then the following aspects should be considered;

- balanced positions should be distinguished from outright long positions
- a proportionality rule should be introduced to limit unjustified administrative burdens.

### 1.5.4. Removal of unrealized gains and losses on debt instruments, loans and receivables and equities from Tier 1

With regard to unrealized gains and losses, we would like to point out that there should be symmetry in the treatment of unrealized gains and unrealized losses, and this principle should be maintained as pending accounting changes are factored in.

As regards any work on this matter, we would recommend waiting until US GAAP and IFRS amendments on financial instruments as well as transition provisions are fully finalised. Otherwise new rules on unrealised gains and losses could lead to unintended swings in the capital base due to changes in accounting standards. In order to reduce the need for prudential filters, it is crucial that accounting standards allow for a proper consideration of the actual business model of financial institutions and do not introduce artificial volatility in equity.

With regard to the possible deductions from Tier 1 and current projects on IFRS 9 and prudential filters we would like to point out the following aspects:

- Unrealised gains are often linked to strategic equity investments. From a prudential perspective, it seems fully appropriate to reflect the growth of the value of such strategic investments, which are often held over long periods when calculating the own funds of the bank<sup>6</sup>. Supervisors may consider applying a haircut<sup>7</sup> to the value of the investment and/or accepting the unrealised gains as gone-concern capital only, but to fully filter unrealised gains whereas on the other side capital losses are deducted at 100% from tier one, clearly does not make sense.
- According the exposure draft of IFRS 9 banks *“will have to make an irrevocable election to present in other comprehensive income subsequent changes in the fair value of an investment in an equity instrument”*. This means that if the investment is sold, the profit would no longer be recognised in net income but in equity. There will be no rationale for developing short term or medium term activities with unrealised gains recognised in equity. Thus, “strategic investments will no longer go through P+L. For the reasons mentioned above, such unrealised gains should not be fully filtered out.

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<sup>6</sup> Example: If a bank buying a stock of 100 and this investment has after holding it for 20 years a value of 300, it does not seem realistic to base the value of the investment on the original value of the investment for its capital base (numerator).

<sup>7</sup> E.g. haircuts in Belgium are 20 % and in France 55 %.



### **1.5.5. Investment in the capital of certain banking, financial and insurance entities**

#### **General Remarks**

While the concern about “double counting of capital” makes some sense with respect to investments in other banks, the members of the EACB take the view that the proposals seriously overshoot their prudential goals:

- First, a market-making exception is required, among other things to be sure that markets can be made in the securities of smaller banks.
- The principle of deduction should not be applicable for participations where certain regulations determine a consolidation of own funds. This is already the case in consolidating groups and – under certain circumstances – in decentralized groups in the European Union. Participations in such non-consolidating groups should not have to be deducted because “double gearing” is avoided by the consolidation of own funds on group level.
- These cases are different from the minority interest issue (where the deductions have to be made in the consolidating entity), since normally every single bank has to deduct its participation in the common central institution when calculating solvency requirements on a solo basis.
- Moreover it seems to be adequate if the deduction is applied to the entire tier 1 capital as opposed to core tier 1 capital because concerning loss absorbency there is no difference between tier 1 and core tier 1 capital.
- More generally, it seems not appropriate to extend the same treatment of deduction of Core Tier 1 Equity to other financial institutions. The risk-based justification for the proposal is not obvious. Where there are offsetting short or derivative positions for positions in other financial institutions, the normal trading-book and counterparty-risk capital requirements would apply.
- Only direct participation should be taken into consideration.

#### **Investments in insurance entities**

With respect to the deduction of the participations in financial institutions, we urge to restrict the scope of this deduction to discard insurance companies. The full deduction is not the right answer to participations in insurance companies.

We strongly ask for the maintenance of the current EC regime of the conglomerates Directive

- we call on regulators to focus in priority on the implementation of Solvency 2 (and its equivalents outside of the EU) and now on the forthcoming Basel 3 framework before any review of the regulation in the conglomerate field.
- we request that no redundancy or interference to the current treatment should be made until the calculation of capital adequacy rules on a conglomerate basis is reviewed and updated globally within the appropriate bodies, ie the Joint Forum.
- More specifically, we recommend that the Basel Committee harmonises the international prudential practices by adopting the procedures of conglomerates which already exist in European groups, in line with the recommendations of the Joint forum.



First of all, it should be mentioned that substantial holdings in insurance companies allow banking groups to significantly enlarge the range of products they are offering to their customers, at a competitive price, through a common distribution channel.

However, risks borne by insurance companies are of different nature compared to the banking risks. In the insurance sector, the main risks are composed of:

- (i) underwriting risks (insurers predict the likelihood that a claim will be made against their policies and they price their products accordingly) and
- (ii) asset management risks (companies have to ensure that the premiums and life insurance deposits they receive are invested in an appropriate way).

The requirements on investments are also different, in particular since the insurance investment period is typically very long-term. Banks and insurance companies are therefore regulated by specific regulatory requirements: in Europe, banks must comply with the Basel 2 prudential requirements, known as the Capital Requirements Directive (CRD) in the EU, while insurance companies are subject to the Solvency 1 and tomorrow the Solvency 2 directives.

The issue of potential double counting effects of own funds between banks and insurance companies, has been identified in the late '90s by the Joint Forum (a working group of the BSBC, IOSCO and the IAIS) and has proposed "*measurement techniques and principles to facilitate the assessment of capital adequacy on a group-wide basis*". In the EU, these recommendations were translated into the Financial Conglomerate Directive (EC 2002/87) in 2002. This global framework has now been operational for several years in all EU countries and has strongly proved its efficiency during the recent crisis.

The absence of double counting is analysed on the one hand at a global level (conglomerate ratio) and on the other hand at the banking and insurance level respectively.

Indeed, the way the conglomerate directive may be applied following the methods proposed by the Joint Forum correctly takes into consideration this consolidated approach as follows:

- a global control of the solvency of the conglomerate through the calculation of an "observation ratio". The latter is produced by adding up the requirements of the banking activities and those of the insurance group and by comparing this amount to the consolidated total capital of the group (intra-group transactions being eliminated) to ensure that the requirements are fully covered;
- for the bank solvency calculation, including:
  - deductions from the core tier one for the goodwill relating to insurance purchases ;
  - deductions from tier one for the part which relates to the double counting in the tier one (i.e. neutralisation of the insurance reserves and elimination of the potential capital gains and losses booked in the insurance companies as they would otherwise also appear as banking capital due to the prudential consolidation methodology which is used); equity participation risk weighting for any remaining holdings.

It should also be mentioned that this prudential assessment is integrated in an additional stringent European EC framework for all financial groups which have been designated as conglomerates, with more constraints than Basel 2 framework on larges exposures, sectoral analyses (equity investments, real estate), internal control issues and a review and elimination of the reciprocal transactions between the banking entity and the insurance one.



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This double geared system includes therefore a full monitoring of all the risks taken by financial conglomerates and the careful control of their capital coverage.

#### **1.5.6. Deferred tax assets**

The consultative document states that deferred tax assets (“DTAs”) that rely on future profitability to be realised should be deducted from Predominant Core Tier 1. We recognise that a certain degree of prudence may be required for allowing DTAs in regulatory capital as their value can be affected in periods of economic stress. However, we see little justification for such a draconian deduction, which in our view fails to take into proper consideration the various categories of DTAs and the real value of DTAs on a going concern basis.

According to most accounting standards (e.g. IFRS, US GAAP, UK GAAP etc.), the objective of accounting for income taxes in the Profit & Loss statement is to recognise not only the amount of taxes payable or refundable for the current period but also deferred tax reflecting the future tax consequences of events recorded in the financial statements during that period.

We are not opposed to setting clear and transparent rules internationally to avoid undue reliance on DTAs in regulatory capital but consider that the proposed blanket rule deduction is unwarranted and will entail undesired effects.

##### 1.5.6.1. Dependence upon future profitability

DTAs dependent upon future profitability arise both from tax loss carried forward and timing differences between the recognition of gains and losses in financial statement and their recognition for tax computation. Such timing differences commonly derive from the numerous discrepancies between tax and accounting rules, which vary greatly depending on tax laws and jurisdictions.

In reporting net DTAs companies are required by accounting standards to make an assessment of recoverability based on assumptions and estimates of future taxable profits. Importantly, this assessment is subject to scrutiny from external auditors. DTAs will not to be recognised (or will be written off in whole or in part if they have been previously recognised) in case there is not enough certainty that taxable profits will be available to support the utilisation of DTAs in future years. Such write down will decrease net profit reported for the period.

We think that in the context of prudential supervision, a cap expressed as a percentage of capital would be more straightforward and effective than a limit based on a set time horizon. Notably, the suitable time horizon can vary depending upon the business mix of the entity and the reliability of forward looking estimates.

##### 1.5.6.2. Inconsistence with the going concern approach

The logic underlying the proposed deduction, i.e. that DTAs depend on future profitability should hold no value at all whatever the circumstances, does not appear coherent with the “going concern” approach adopted by the Basel Committee for Tier One capital. As explained earlier, DTAs are already subject to an economic value test conducted by external auditors to confirm their recoverability. The time limit set by tax authorities to utilise DTAs is usually very long or unlimited and therefore DTAs may retain value over



the long term as long as the bank is in operation even if they have been temporarily written down. DTAs on tax losses carried forward also contribute substantially to the value of the business or the subsidiary in case it is sold or transferred.

#### 1.5.6.3. Increase of pro-cyclicality

We consider the proposed deduction increases the pro-cyclicality of the capital regime. DTAs resulting from tax losses, loan loss reserves (not always tax deductible) and unrealised investment losses will increase during downturns and be reversed when results improve. As a consequence, the proposed deduction will further deplete capital in periods of economic stress.

#### 1.5.6.4. Discourage "conservative" accounting

The forward-looking provisioning scheme advocated by the Basel Committee will translate into non tax-deductible provisions thereby increasing substantially the amount of DTAs. Deducting such DTAs from (core) Tier One Capital would in part annihilate the benefit of this countercyclical measure and may even discourage conservative accounting.

#### 1.5.6.5. No level playing field

The proposed deduction is in part contradictory with the stated objective to maintain a level playing field. The proportion of DTAs resulting from temporary differences varies widely between countries depending upon local tax laws. Deducting such DTAs penalise banks operating in tax jurisdiction where certain asset value adjustments (e.g. loan loss reserves, impairment, write down) are not tax deductible and this will translate into undesirable distortions based on the localisation of a bank's activities.

#### 1.5.6.6. Recommendation to devising a partial deduction rule

We urge to consider a more balanced approach for DTAs such as the partial deduction rule already applied in some countries.

Some banking regulators already deduct DTAs only for the portion exceeding a specified maximum proportion of capital and this could be generalised for instance by deducting net DTAs from Predominant Core Tier One only above a threshold equivalent to a percentage of Tier One Capital, to fix after impact assessment.

However, we consider that full allowance in Predominant Tier One Consideration should be maintained for DTAs resulting from discretionary forward looking provisions.

### **1.5.7. Stock surplus**

According to paragraph 93, 'Stock surplus (i.e. share premium) will only be permitted to be included in the Common Equity component of Tier 1 if the shares giving rise to the stock surplus are also permitted to be included in the Common Equity component of Tier 1.

Stock surplus relating to shares excluded from the Common Equity component of Tier 1, e.g. preference shares, must be included in the same element of capital as the shares to which it relates.

We think that stock surplus (share premium) has been paid in cash, irrespective of how the shares, which have originated it, were classified. This reserve is fully available to





cover losses, so we do not see any reason to discriminate between the parts of the stock surplus depending on the classification of the related shares.

### **1.6 Additional Going Concern Capital**

As regards the additional going concern capital, the proposal is to fully phase out “innovative” hybrids altogether, but the scope of what is to be excluded is not clear.

There are several open technical questions on the proposals as to hybrids as well. To give one example, the proposal singles out step-up clauses as an example of an incentive to redeem for hybrid capital instruments, and states that instruments with such incentives cannot be included in Additional Going Concern Capital. A proportion of instruments with step-up features should, however, be acceptable, subject to specific analysis of the likely effects of a particular transaction. One of the benefits of allowing such instruments where appropriate could be by providing useful diversification of financing instruments. The extensive work of CEBS over the past three years shows it would be possible to achieve common definitions, appropriate buckets, and sensible economic limits for a somewhat broader range of hybrids than seems to be contemplated at this moment. We would suggest therefore to further study this subject.

In recent discussions some of the main advantages have not been taken into account to a sufficient degree: flexibility, access to various investors etc. furthermore, we would like to emphasize another positive aspect of hybrids: they allow to issue capital in foreign currencies which will be necessary to prevent volatility in solvency core tier one ratios due to foreign exchange fluctuations.

If banks are too strictly limited to a narrow set of instruments for their different capital baskets, it will be challenging for the market to absorb new offerings at a normal pricing level, especially if a great deal must be done over a short period of time. The ability of a capital-dependent industry to have access to deep, broad and varied sources of funding in markets that vary over time is fundamental. The present proposals therefore need to take a more market-sensitive approach to the definition of allowable instruments.

The proposals restricting indirect issuance via special-purpose vehicles are too far-reaching and need to be modulated to address the tax and corporate needs of issuers in certain countries, which could be done without compromising the prudential goals of the proposals. In our opinion an indirect structure could fully meet all fundamental objectives of a capital instrument (loss absorbency, permanence).

### **1.7. Tier 2 Capital**

The maturity and amortization guidelines for Tier 2 capital outlined in the document are needlessly restrictive. The five-year minimum-maturity in respect of calls needs re-examination given the purpose of Tier 2 capital as “gone concern capital”.

As all calls as well as exchange initiatives of the issuer are conditionally to supervisory approval, a minimum term is of limited use. Only in sound conditions and if the supervisor agrees to the call it is affected. Therefore, the ability of the issuer to call or exchange an instrument under the proper conditions should be allowed any time.

## **2. RISK COVERAGE (110-201)**

Appropriate capitalization of risk to ensure prudentially sound financial institutions and the wider financial stability is necessary to protect the economy.



- The EACB believes that there is no need for punitive charges for contracts that are not CCP cleared (165-167). The zero risk weighting of CCP cleared contracts already offers a strong incentive to move to CCPs.
- As regard to cliff effects arising from guarantees and credit derivatives, we fully agree with the proposal in paragraph 198 and 199 to abolish the limitation of A-rating for eligible guarantors, both for the standardised approach and the foundation IRB approach, because the mentioned cliff effects can be very important for the smaller institutions.

In addition, the credit valuation adjustment in relation with the OTC derivatives is used in the IFRS accounts, but they do not exist everywhere in the national accounting standards. The national accounting standards in some countries the OTC derivatives are off-balance sheet items, and the value adjustments are related to the market value and not to the counterparty credit risk. As many small institutions in the EU do not prepare their accounts according to the IFRS and the annual accounts according to the IFRS are available sometimes only on a consolidated level, we think it would be important to describe the proposal also for instance with the terms of the Directive 1986/635/EEC on the annual accounts of the banks.

It is not very clear, whether the banks using the standardised approach for credit risk should also calculate the capital requirement for the credit valuation adjustment. It is not explained either that in case of credit institutions where neither the CDS spread nor the bond spread is available, how the credit valuation adjustment should be calculated.

### **3. LEVERAGE RATIO (202-238)**

The EACB strongly disagrees with the leverage ratio, and we really wonder whether in a highly leveraged sector a ratio without any risk sensitivity would have a meaning at all. Binding leverage ratio is a simplistic, non risk-sensitive regulatory tool that does not fit into the capital requirements framework.

In fact, introducing a leverage ratio as a binding standard could have the same effect as an immediate increase of the level of regulatory capital and thus could hamper economic recovery. Moreover, as the leverage ratio is not a risk-sensitive metric, the increase of the level of the regulatory capital would have a much stronger effect for less risky exposures than for more risky ones and thus create an adverse effect on risk taking.

By no means should the relevance and reliability of a leverage ratio be overestimated. A leverage ratio does not consider aspects such as granularity of the portfolio and diversification aspects. Furthermore, a leverage ratio treats all exposures as equal and negates the risk-weights and parameters established by the Basel Committee, which are based on varying grades of risk inherent in individual exposures. While it is argued that for all these reasons a leverage ratio may deliver a necessary complement, its total risk-averseness is striking. Therefore, the weight of such a ratio in the prudential framework should be limited.

Moreover, we are not convinced that a leverage ratio should fully ignore risk weights. If a ratio were calibrated too tight, it would generate incentives to do less business, but possibly more risky business, which could be counterproductive. In particular, there is a danger that banks that have focused on low-risk exposures (e.g. loans to municipalities, residential mortgages) might be obliged to reduce their portfolios and be obliged to engage in more risky business. The business model of institutions that are specialized in the aforementioned low-risk exposures (e.g. municipal loans) and which are doing well by now, is undermined. One could even call this an adverse incentive.



Furthermore, if the leverage ratio is introduced as defined in the consultative paper, it should be:

- a final, and not just temporary, measure of Pillar 2;
- “calibrated” so that it will be binding for the categories of intermediaries which tend to build up more leverage - in particular those most oriented to trading activities or specialized in innovative financial sectors - and only in phases of excessive economic growth.

As regards the capital measure the EACB considers more appropriate to use the total regulatory capital, due to its effectiveness to cover potential losses. In any case, it appears too restrictive to consider the *Core Tier 1 Capital*

As regards the definition of total exposures (212-235), there are particular concerns on the following issues:

The EACB believes that the inclusion of highly liquid assets, the exclusion of close-out netting agreements and a CCF of 100 per cent for all undrawn facilities and off-balance sheet items are not justified. We wonder whether it is possible to find a calibration to the ratio which would show anything at all.

Furthermore, for central institutions in a cooperative network, the leverage ratio in its present form has several negative features, such as:

The liquid assets are included in the ratio, while as a central institution the member institution in the network fulfill the minimum reserve requirements through the bank and the bank places the required sum by the central bank. For this reason the size of the liquid assets is much higher than in a credit institution of the same size, which is not a central institution for a co-operative network.

Central institutions in a cooperative network extend a liquidity line for the members of the network in relation to the minimum reserve requirements, for which the CCF is zero. In the leverage ratio all off-balance sheet items are without the CCF factor.

In that context, the EACB would propose:

- 1) The leverage ratio should be calculated without the liquid assets, as defined in the liquidity framework and which is already mentioned in paragraph 219.
- 2) The central credit institution for networks, which fulfill the minimum reserve requirements by the central bank on behalf of the entire network could leave out from the calculation all the assets and off-balance sheet items which are related to the smooth functioning of the fulfillment of the minimum reserve requirements for the entire network.
- 3) To apply the CCF of the standardized approach for the calculation of the leverage ratio

## **4. PROCYCLICALITY 239-262**

### **4.1 Cyclicity of the minimum requirement**

The Committee's proposals in the consultative document are highly principle based at the present stage. The Committee's intention to assess the cyclicity of the minimum requirement has our support. However the EACB has some concerns on how provisioning in financial accounting (IFRS) might deviate from through-the-cycle provisioning for expected credit losses. We are also sceptical of the use of a macro-economic variable or



group of variables as well as the discretionary means given to the central banks and the supervisors.

#### **4.2 Forward looking provisioning**

We would like to recall that the lack of capital was not the reason of the crisis but just one of its consequences. The triggers of the crisis were the inaccuracy in capturing the risk behind some sophisticated financial products (i.e. mortgage backed securities) and unsound lending mortgages practices in the United States. A highly inaccurate rating by the rating agencies lead investors to trust apparent conservative financial instruments that turned out to be extremely risky. In that way Dynamic provisions will not address this particular problem if it is ever to be repeated as the capital adequacy issue is just a consequence of the crisis.

Considering the above, EACB has some doubts regarding the effectiveness in implementing such a measure and we are therefore not fully convinced of the underlying idea of Dynamic Provisioning. Nevertheless, if Dynamic Provisioning is to be implemented we should mention the following.

We would also like to add a practical consideration to the forward looking provisioning. As stated in this document, forward looking provisioning, would require that expected losses are reflected in the IASB's Accounting Standards accordingly. However, we believe that this is currently not the case. In fact we even do not see that the IASB's project on expected loss provisioning will provide any solution in this respect.

As regard through-the-cycle-provisioning we shall point out that the focus is set on expected losses. However, this criterion is only used by IRB banks. The standardised approach is not based on expected and unexpected losses concept. The Basel II risk weights in the standardised approach were intentionally simplified in order to be not too complicated and to be similar in many respects to the Basel I capital adequacy framework, therefore risk weights reflect very little, if at all, the expected losses.

Furthermore the risk-weights do not differentiate between the real risks of the market participants, which should be reflected in the EL in the case of

- the risk weights based on the sovereign applied for institutions and regional/local governments;
- the risk weights for the corporate sector;
- the risk weights of the retail sector;

Therefore, banks applying the standard approach would be pressed to IRB, since there expected losses are not provided for in the standard approach. This must be opposed against the backdrop of equality (which is regularly confirmed by supervisors) of standard and IRB approach.

#### **4.3 Building buffers through capital conservation**

- Concerning Capital Conservation Buffers there are relevant doubts, whether banks would be able to provide for the required capital at all. An investor's interest to acquire a share in a bank will be low, because an unrestricted distribution shall only be allowed, if the minimum capital is exceeded by 100%.
- In that context banks will suffer a massive competitive disadvantage compared to non-banks, because investors will preferably invest in the latter business (which are not subject to distribution restrictions). A run for capital with significant disadvantages for banks will be the result.



- We strictly oppose the simultaneous creation of additional “reserves” and distribution restrictions.

In addition, it is not exactly clear how the capital conservation buffer would work. In our understanding the capital conservation standards are bank specific, and they are built on the minimum capital requirement, which is disclosed. However it is not exactly clear, what is the relationship between the capital requirement taking into account the SREP and the level of the capital conservation standard. This point should be clearly defined.

The capital conservation standard would be applied on a consolidated level. However, it is not clear how the dividend payment on a solo level could be reconciled with the standard on a consolidated level; also because in the subsidiaries, the general meeting is usually earlier than in the parent company. Therefore, it would be very difficult to calculate exactly how much dividend should be retained at the subsidiaries.

The counter-cyclicality of the buffer would be expressed by an add-on, which means in our view the increase or decrease of the capital conservation standard. Even if clear rules are defined when and to what extent the capital conservation level is to be increased or decreased, capital planning would be very difficult because of the uncertainty of the capital conservation level in the medium term.

From an accounting point of view the undistributed profit should be a part of the other reserves, because it is a legal reserve which could be used only for covering losses. However, since it is a reserve, it is an element of own funds, too, and if so, it can generate more business. The counter-cyclical effect of the buffer for this reason is not clear.

According to the proposal, capital should be increased after the first signs to a coming downturn, which may strengthen procyclicality.

As regards to the *“additional supervisory discretion”* to impose time limits on bank operating within the buffer range to rebuilt it the EACB believes that it should be exercised taking into account the legal peculiarities of cooperative banks and their structural limitations to put outstanding transactions to increase capital (most of them are non listed companies and do not have access to capital markets). Otherwise, banks operating within the buffer limits, in order to reconstitute the latter in the timeframe specified by the supervisor, could put in place quick actions to reduce lending/RWA, thus strengthening pro-cyclicality. Furthermore, it should also be taken into account that in some jurisdictions the law already provides a “system of capital conservation” for cooperative banks. For instance, the Italian Banche di Credito Cooperativo must allocate 70 per cent of yearly net profits to legal reserve (in order to increase and reinforce the capital).

Referring to the proposal of considering only the Tier 1 capital to cover the buffer the EACB considers more appropriate to use the total regulatory capital, due to its effectiveness to cover potential losses.

Finally, the consultation proposal (258) limits dividend distribution based on counter-procyclical concept.

For many cooperative bank groups, dividends from a group central bank play an important role for the financial stability of the group member financial institutions. Therefore, simplistic limitation of dividends, especially at a group central bank level, is inappropriate from a group-wide stability viewpoint.



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#### **4.4 Excessive credit growth**

- There are some concerns on the procyclicality measures as from the consultation paper it is not clear at all what that would mean for the banks using the standardized approach (small banks).
- It is also not clear how that would work in practice in countries where already there is an element like general reserves or general provisions, and both are included in the Tier 1 capital.
- Although counter cyclical measures are positive, the economic system itself is procyclical, so it should be considered the limits that prudential regulation should achieve in that regards as this is a very important issue.
- It needs to be properly assessed the cumulative impact of the proposed measures as it might be the danger of overlapping effects, in particular between dynamic Pillar 1 measures, Dynamic Provisioning and Countercyclical Buffers.
- As regard to paragraph 261, the EACB has some concerns on how this adjustment could work, whether the adjustment would relate to all institutions, even where the credit growth was below the average or only to some institutions. In any case we think that this would increase the instability of the real size of the capital conservation standard and capital planning would be very uncertain. We also fear that this idea could discourage investors to invest in the banking sector. Moreover any kind of adjustment of the capital conservation standard may increase the legal concerns.
- The consultation document considers the buffer relative to the excessive credit growth as an increase of capital buffer range, established through the capital conservation proposal. We highlight some problems of interpretation for the periods of coexistence between the two measures. In particular, is not clear whether the conservation standards should apply to the sum of the two buffers.
- Within one jurisdiction, economic development and finally excessive credit growth may differ significantly. While in highly industrialized metropolitan areas excessive credit growth might occur, this might not be so in less developed rural areas. Any future prudential model should be flexible enough to ensure that macro variables do not interfere into the development of less-developed areas, by imposing such "brakes" on local banks operating in such regions.