AUSTRIA

Answers of Oesterreichische Nationalbank, Financial Market Authority and Federal Ministry of Finance to the Questions contained in the

COMMISSION SERVICES STAFF WORKING DOCUMENT

Possible Further Changes to the Capital Requirements Directive

Management Summary

Austria agrees that the global financial system has to be strengthened. An internationally consistent regime for capital and liquidity has to be a precondition to achieve this objective. Austria therefore supports the objective of introducing a package of reforms that are closely aligned with the changes to the international capital and liquidity standards that the Basel Committee is currently consulting on.

It will be essential to ensure that the aggregate impact of the full package of regulatory reforms agreed by the G20 is assessed, and that this assessment is taken into account when calibrating and implementing CRD IV. It must be ensured that regulation strikes a balance between enhancing financial stability and supporting strong and sustainable economic growth.

Within the overall package of proposed reforms to the CRD set out in the Commission services Staff Working Document, we have identified the following key issues:

Capital:

We support the Commission's efforts to enhance the quality of capital and simplify the current capital structure. Adequate calibration and timing of the proposed measures will be crucial.

The following points are of particular importance for Austria:

- The exact proportion of core tier 1 to other tier 1 components should be based on the results of the QIS; however, we believe that in any case a definition of "predominance" close to 50% would be most appropriate;

- Capital received from minorities shall be included in core tier 1 if directly contributed to credit institutions within the same group;

- Holdings of credit institutions which receive a zero percent risk weight as an intragroup exposure under the standardized approach (Art. 80 (7) and (8) CRD) for credit risk, shall not be deducted from the own funds given that the consolidated capital requirements are fulfilled;

- Adequate grandfathering-rules that ensure recognition according to the current classification of capital instruments shall be preserved; and

- A level playing field has to be established between joint-stock companies and non joint-stock companies on the basis of a principle-based approach.

Liquidity

Austria fully supports the harmonisation of liquidity standards throughout the EEA, as it will enhance the stability of the banking system.

The following points are of particular importance for Austria:

- The suggested stress scenarios are too excessive and should be amended accordingly.

- The narrow definition of liquid assets is seen as detrimental; negative consequences in times of system-wide liquidity stress thus will be unavoidable. A well diversified portfolio of liquid assets is seen as crucial, where central bank eligibility should be a main criterion.

- The design of liquidity requirements should ensure that business models which have proven to be stable in times of crisis (like retail banking) will be fostered (or at least not be put at disadvantage compared to other business models).

Countercyclical measures

Austria generally supports efforts to mitigate cyclicality in the current regulatory regime. The following points are of particular importance for Austria:

- Austria supports measures to dampen procyclicality. In order to fulfil this objective, these measures must not lead to a permanent increase in capital requirements in the sense of the proposed fixed target buffer. The built-up buffers only dampen procyclicality if they can be used/reduced when necessary over the economic cycle, otherwise they may have even procyclical effects.

- Measures to dampen procyclicality have to take different business concepts and their impact on financial stability into account.

- The system of conservation buffers needs to be thoroughly calibrated. We consider the proposed constraints on distributions as too severe. The suggested calibration would have to be thoroughly evaluated keeping in mind not to disproportionally impede the credit institutions’ ability to raise capital on capital markets.

Section I: Liquidity standards

General Remarks: Austria welcomes the introduction and international harmonisation of quantitative minimum requirements for banks' liquidity and a functional approach taken to their determination. Furthermore, we generally support the proposed option for the use of the waiver. Regarding smaller institutions Austria stresses the importance of a bifurcated approach to give consideration to proportionality as stated as leading principle in recital 41 (Directive 2006/48/EC).

The challenges that banking groups comprising subsidiaries outside the EEA potentially have to face within the context of liquidity risk management not only apply on a consolidated level to a EU parent credit institution. Any entity at subconsolidated level could just as well be exposed to issues arising from divergent standards on solo level within and outside the EEA. Therefore, we favour an approach that allows for the application of liquidity risk standards at subconsolidated level, following a joint decision process and mutual understanding within the College of Supervisors, supposable upon request of the supervisor responsible for the supervision of the subconsolidated entity.

Question 1: Comments are sought on the concept of the Liquidity Coverage Requirement and its likely impact on institutions' resilience to liquidity risk. Quantitative and qualitative evidence is also sought on the types and severity of liquidity stress experienced by institutions during the financial crisis and – in the light of that evidence – on the appropriateness of the tentative calibration in Annex I. In particular, we would be interested in learning how the pricing of banking products would be affected by this measure

The focus on a single short-term measure will not significantly increase the institutions' resilience to liquidity risk, because the time horizon of the stress tests is quite short (cliff effect!) and the scenario is similar to scenarios tested by banks anyway. It is important that banks do not only rely on the stress tests incorporated in legislation, but conduct their own range of liquidity stress tests. In addition, the product oriented definition of the scenario and the focus on a single measure provide strong incentives for banks to innovate products and to engineer funding circumventing the measures.

First, we are particularly concerned that a narrow definition of liquid assets is inconsistent with the functional approach. It will lead to unintended consequences such as increased concentration risk, negative systemic impact in times of system-wide liquidity stress (second round effects), and increased vulnerability to sovereign risk. Prudent risk management calls for a functional approach to the counterbalancing capacity as well (and not only to the cash flows); i.e. the scenario should entail parameters for a range of liquid assets and leave the composition of the counterbalancing capacity to banks given the quantitative minimum requirement in the LCR and the parameters of the scenario. The CEBS Guidelines on Liquidity Buffers and Survival Periods call for a well diversified portfolio of liquid assets. The CRD IV should follow this approach and allow for a prudent composition of the portfolio of liquid assets. Finally, the narrow definition will provide strong incentives for banks to off-load low quality collateral at central banks and hold high quality collateral as liquid assets.

Second, concerning the pricing of products we expect that higher costs of liquidity will be priced in those bank assets that are particularly liquidity intensive and where banks have some price setting power. Under the draft CEBS Guidelines on Liquidity Cost Benefit Allocation the additional opportunity costs of holding a higher and narrower liquidity buffer must be accounted for by the internal funds transfer price. Given the low margins in Austria and the fierce competition for deposits, we expect that higher internal fund transfer prices will be reflected in the pricing of bank products predominantly on the banks' asset side (increased loan rates), but also on the banks' liability side (increased rates for long-term bank deposits, such as savings accounts).

Third, some scenario parameters should be reconsidered. For example, the assumed cash-outflow of 100 percent of undrawn liquidity lines for non-financial corporates seems to be unrealistic even under the most severe stress conditions and inconsistent with a severe economic downturn that underlies the stress scenario.

Fourth, the scenario has unintended consequences that are detrimental to financial stability. For example, the very restrictive treatment of interbank deposits will lead to a decrease in interbank market activity and stability. This reduces the ability of the market to redistribute liquidity within the system, and impacts the monetary transmission mechanism and the implementation of monetary/liquidity policy by central banks. More banks would have to participate in open market operations, the structural liquidity deficit will increase, and banks will have to hold higher precautionary liquidity reserves (on top of the LCR and the respective buffer), since their access to the money market would be severely restricted. The parameters should be determined after a cost-benefit analysis based on the QIS data.

Question 2: In particular, views would be welcome on whether certain corporate and covered bonds should also be eligible for the buffer (see Annex I) and whether central bank eligibility should be mandatory for the buffer assets?

In the light of the above, corporate bonds, covered bonds and other liquid assets should be part of the portfolio of liquid assets. The scenario should entail stressed haircuts for these assets but leave the composition of the portfolio to the banks. The current approach contradicts the CEBS Guidelines on Liquidity Buffers and Survival Periods and prudent liquidity risk management. Furthermore, it exposes banks to substantial concentration and sovereign risk. Including central bank eligibility as criterion increases the options for diversification and reduces negative repercussions for market liquidity in many asset classes currently not included in the portfolio of liquid assets. However, it must be clear that banks must not rely on extraordinary liquidity providing operations of central banks.

Question 3: Views are also sought on the possible implications of including various financial instruments in the buffer and of their tentative factors (see Annex I) for the primary and secondary markets in which these products are traded and their participants.

We favour a broad and well diversified composition of the buffer with stressed haircuts for broad categories. The definition of deep and liquid markets provided in Annex I is not suitable for smaller countries and puts banks from these countries at a substantial disadvantage vis-à-vis those from large financial centres. Some of the mentioned criteria are too detailed, static and without proper empirical foundation (e.g. the criteria regarding bid-ask-yield spreads) so that as a consequence all “additional” assets might be excluded in practice.

Question 4: Comments are sought on the concept of the Net Stable Funding Requirement and its likely impact on institutions' resilience to liquidity risk. Quantitative and qualitative evidence is also sought on the types and severity of liquidity stress experienced by institutions during the financial crisis and – in the light of that evidence – on the appropriateness of the tentative calibration in Annex II. In particular, we would be interested in learning how the pricing of banking products would be affected by this measure.

The Net Stable Funding Requirement might increase banks’ resilience to liquidity risk in the given scenario, but at the expense of restricting banks to conduct one of their major functions in society, namely that of liquidity and maturity transformation. The impact might be substantial, both in terms of increased long-term funding which leads to increased funding interest rates and in terms of reduced liquidity and credit lines for businesses and households. The additional long-term issuance volume triggered by the NSFR is estimated to amount to between EUR 1,100 bn and EUR 3,000 bn at EU level[1]. The parameters should be determined after a cost-benefit analysis based on the QIS data.

Question 5: Comments are in particular sought on the merits of allowing less than 100% stable funding for commercial lending that has a contractual maturity of less than one year. Is it realistic to assume that lending is reduced under liquidity stress at the expense of risking established client relationships? Does such a differentiation between lending with more and with less than one year maturity set undesirable incentives that could discourage for instance long term funding of non-financial enterprises or encourage investment in marketable securities rather than loans?

While consideration concerning the franchise value of banks should play a role in determining the actual liquidity of assets such as short-term loans, the assumptions in the NSFR are counterfactual, both with respect to corporate and retail clients. In particular, it is

[1] Citi Bank, 2010; Liquidatum ltd., 2010

not warranted that retail client loans carry a significantly higher weight than corporate clients as the rollover rates of retail loans is usually lower. Both should be reconsidered after a cost-benefit analysis based on the QIS data.

Question 6: Views are sought on possible implications of inclusion and tentative "availability factors" (see Annex II) pertaining to various sources of stable funding for respective markets and funding suppliers. Would there be any implications of the tentative required degree of coverage for various asset categories for respective bank clients?

The low weights assigned to retail and corporate deposits as well as to wholesale-funding (non-maturing or residual maturity < 1 year) are unwarranted; large shares of household financial wealth are invested with non-bank financial intermediaries. To curtail the access of the banking system to these sources could be inefficient for banks and non-bank financial intermediaries. The weights should be reconsidered after a cost-benefit analysis based on the QIS data.

Question 7: Do you agree that all parameters should be transparently set at European level, possibly in the form of Technical Standards by the EBA where parameters need to reflect specific sub-categories of retail deposits?

The product oriented definitions in both standards provide strong incentives for banks to innovate so as to circumvent the product definitions. Thus, products that have the same liquidity risk characteristics would not be treated alike. A functional definition would be more flexible and hence preferable. Even technical standards need time to be adapted. The number of different products in the EU is so large that the technical standard would represent a rather inflexible and continuously outdated instrument. However, setting the parameters at the European level by the means of Technical Standards by EBA is preferable to their inclusion in the CRD. National specificities should be limited to justified cases.

Question 8: In your view, what are the categories of deposits that require a different treatment from that in Annexes I and II and why? Please provide evidence relating to the behaviour of such deposits under stress.

In Annexes I and II the assumed cash-outflows from retail deposits are too high. During the crisis funds flowed from mutual funds and other non-bank financial intermediaries to the banking sector. For insured deposits the run-off rate should be less than 5 percent in LCR; the run-off rate for uninsured retail deposits should be 10 percent; that of unsecured wholesale funding by non-financial corporates 25 percent and that of other legal entities 50 percent. Also the run-off rate of repos in assets which are not eligible for the buffer is by far too high. This category needs more differentiated treatment. However, if a very general category for repos is to be maintained the run-off rate should be 50 percent. The parameters should be reconsidered after a cost-benefit analysis based on the QIS data.

Question 9: Comments are sought on the scope of application as set out above and in particular on the criteria referred to in point 17 for both domestic entities and entities located in another Member State.

Austria generally supports the proposed scope of application. In principle, waivers at the national and cross-border level are welcomed. The underlying procedure for cross-border waivers (joint decision of competent authorities) seems appropriate in order to prevent potential trapped pools of liquidity where possible. However, the challenges that banking groups comprising subsidiaries outside the EEA potentially have to face within the context of liquidity risk management not only apply on a consolidated level to a EU parent credit institution. Any entity at subconsolidated level could just as well be exposed to issues arising from divergent standards on solo level within and outside the EEA. Therefore, we favour an approach that allows for the inclusion of application of liquidity risk standards at subconsolidated levels, following a decision process and mutual understanding within the College of Supervisors, supposable upon request of the supervisor responsible for the supervision of the subconsolidated entity.

As the European Commission intends to introduce liquidity requirements also at consolidated level, we would like to point out the particular structure of some decentralised Austrian groups of credit institutions (see also answer to question 17) that might make it difficult to fulfil those requirements in the absence of a bifurcated approach. This is due to the fact that deposits are collected on a primary and loans are granted on a secondary level. This applies to such regional or local credit institutions with which the central credit institution is associated in a network in accordance with legal or statutory provisions and which are responsible, under those provisions, for cash-clearing operations within the network. Appropriate consideration of these groups will be required. Paras. 23 and 24 seem to be a starting point in the discussion.

The scope of application should take into account the results of the European QIS which also covers smaller banks and decentralised sectors.

Question 10: Should entities other than credit institutions and 730K investment firms be subject to stand-alone liquidity standards? Should other entities be included in the scope of consolidation liquidity requirements of a banking group even if not subject to stand alone liquidity standards?

We agree with the limitation of the application of liquidity standards to credit institutions and 730K investment firms.

Question 11: Should the standard apply in a modified form to investment firms? Should all 730K investment firms be included in the scope, or are there some that should be exempted?

See question 10.

Question 12: Comments are sought on the different options and in particular for how they would operate for the treatment of intra-group loans and deposits and for intra-group commitments, respectively. Comments are also sought as to whether there should be a difference made between the liquidity coverage and the net stable funding ratio.

We support the implementation of a symmetrical treatment of intra-group exposures when it comes to the calculation of both LCR and NSFR. The symmetrical approach would lead to an equivalent treatment of credit institutions that are part of larger groups compared to smaller “stand alone” entities. At the same time, there would be no preferential treatment of intra-group exposures.

Question 13: Do stakeholders agree with the conclusion that for credit institutions with significant branches or cross-border services in another Member State, liquidity supervision should be the responsibility of the home Member State, in close collaboration with the host member States? Do you agree that separate liquidity standards at the level of branches could be lifted based on a harmonised standard and uniform reorganisation and winding-up procedures?

Due to the legal form of branches, we think that the supervision should be the responsibility of the home Member State, in close collaboration with the host Member State.

Question 14: Comments are sought on the merit of using harmonised Monitoring Tools, either in the context of Supervisory Review or as mandatory elements of a supervisory reporting framework for liquidity risk. Comments are sought on the individual tools listed in Annex III, their quality and possible alternatives or complements.

In general, we appreciate the introduction of harmonized monitoring tools based on the “Liquidity ID Card”.

When it comes to monitoring concentration risks, we would like to stress the particular structure of some decentralised Austrian groups (regional or local credit institutions with which the central credit institution is associated in a network in accordance with legal or statutory provisions and which are responsible, under those provisions, for cash-clearing operations within the network). Decentralised institutions will probably reveal high exposures (and therefore concentration risks) towards the central credit institutions due to cash-clearing operations. Therefore, there should be a differentiation in supervisory actions for such groups similar to the exemption provided for by Article 113 (4) lit. d CRD II (or a different definition of the term “group” and “consolidation”, cp. Q 9).

SECTION II: Definition of Capital

General remarks: We strongly support all efforts to enhance the quality of capital. However, due to the as yet unknown results of the quantitative impact study, we would like to underline the importance of adequate calibration and timing of the proposed measures. The cumulative effect of the proposals will have to be thoroughly assessed and taken into account before any final decision is taken.

The exact proportion of core tier 1 to other tier 1 components should be based on the results of the QIS. However, we believe that in any case a definition of "predominance" close to 50% would be most appropriate. Furthermore, we believe that holdings which receive a zero percent risk weight as an intragroup exposure under the standardized approach for credit risk (Art. 80 (7) and (8) CRD), shall not be deducted from the own funds.

We would also like to underline that there is a recognised, and justified, need for some flexibility on the part of the institutions in raising and managing their capital. Some attention should, therefore, be given to the continued marketability of the instruments issued by the institutions.

In addition to the answers to the Commission Services' questions set out below, we consider it essential to clarify that emergency capital provided during the financial crisis does not fall within the scope of application of the proposed regime. This exemption should cover emergency capital underwritten by private market participators as well as emergency capital provided by Member States. At the least we suggest introducing appropriate wording into a Recital to the upcoming Directive.

Question 16: What are your views on the prudential appropriateness of eliminating the distinction between upper and lower Tier 2, and of eliminating Tier 3 capital?

We welcome the re-definition of Tier 2 capital, including the elimination of Upper Tier 2. Tier 2 capital is in our view an important source of funding to the credit institution. It serves a particular purpose in gone concern situations and should be preserved in times of crisis.

From our point of view, criterion 5a for Tier 2 capital[2] already provides a safeguard against the erosion of capital in times of (imminent) crisis. Lock-in clauses might, however, still be a useful complement to this requirement as they are automatically triggered by the onset of a gone concern situation without having to recur to individual decisions by supervisors. They therefore facilitate the resolution of the institution by ensuring the permanence of the capital.

We welcome the abolition of Tier 3 capital.

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[2] To exercise a call option an institution must receive prior approval by the competent authority.

Question 17: Are the criteria proposed for Core Tier 1, non-Core Tier 1 and Tier 2 sufficiently robust and how might they be improved?

We support the efforts to improve the quality of own funds and to raise overall capital levels. For this purpose, we consider the proposed criteria for classification of capital instruments as Core Tier 1, Non-Core Tier 1 and Tier 2 to be sound and robust. We equally support the Commission's initiative to introduce a simplified and transparent capital structure.

However, the introduction of a principle-based approach must not lead to unwarranted competitive distortions between different types of companies.

We recognise that common shares serve as a useful benchmark for defining Tier 1 instruments of the highest quality. However, it is inconsistent with a principles-based approach to base the recognition of an instrument as Core Tier 1 capital on whether said instrument is designated a common share under the relevant (national) laws. As previously pointed out, we would favour an approach that enforces stringent standards without referring to any type of capital instrument. A definition should be sought that is independent of the legal form of the credit institution or of the issued instrument. A strict principles-based regulation should be maintained. For the sake of consistency with the principles-based approach we therefore suggest referring to any capital instrument that is fully compliant with the principles set out in Annex IV irrespective of whether it is, in fact, a common share or a fully equivalent instrument, and whatever the legal form of the issuer.

Furthermore, we suggest maintaining on the European level the political compromise expressed in Recital 4 of CRD II with regard to instruments providing preferential, non-cumulative dividend rights. The relevant company and supervisory laws ensure that any distribution is fully discretionary both as to the payment as such and to the amount to be paid out. In this spirit we support legislation along the lines of criterion 6 of the CEBS CP 33 to ensure the full flexibility of payments. Provided this flexibility is ensured by the law, we think that preferential dividend rights (limited to a multiple of the dividends on ordinary shares, as suggested by para. 69 of the CEBS CP 33) should not hinder the recognition of the instrument as Core tier 1 capital. This should in particular apply to non-voting common shares that give rise to preferential dividends as their holder (apart from exiting the company) have only limited means of putting undue economic pressure on the institution.

In line with Rec. 6 of Council Regulation (EC) No 1435/2003 and the Resolution adopted by the General Assembly of the 88th plenary meeting of the United Nations, 19 December 2001 (A/RES/56/114) regarding a supportive environment in which cooperatives can participate on an equal footing with other forms of enterprise it would not seem to be consistent to favour particular types of company structures over others. A level playing field has to be maintained between joint-stock companies and non-joint stock companies. In this vein we welcome the commitment by the Commission Services to preserve the political compromise and legal formula contained in Recital 4 of CRD II. The specific constitution of non-joint stock companies, in particular cooperative societies, will have to be taken into account and should be preserved.

We furthermore suggest inserting a recital into the proposed Directive that points to the proven stability of the cooperative sector during the financial crisis. Equally, the recital could detail some of the specific features of cooperatives that notably increase their loss absorption faculties. These typically include, inter alia, a long period of notice to require the redemption of the share, a one-year blocking period during which the redeemed capital cannot be paid out to the former member, and the continued liability of the former member for several years even after the execution of the redemption.

We support the Commission's proposal to disregard the tax treatment of coupons/ dividends as a requirement for Tier 1 capital.

We welcome the clarification as to the definition of common equity contained in footnote 18.

Question 18: In order to ensure the effective loss absorbency of non-Core Tier 1 capital, would it be appropriate under certain circumstances to require the write down of the principal amount of an instrument or its conversion to a Core Tier 1 instrument? To what extent should the trigger for write-down/ conversion be determined objectively or at the discretion of an institution or its supervisor?

We also support the proposal that any type of hybrid – whether it is an accounting liability or equity – have a mandatory principal write-down or conversion feature. This feature should not be dependent upon whether the instrument is classified as a liability or an equity instrument.

Question 19: Which of the prudential adjustments proposed have the greatest impact? What alternative, robust treatments might be considered and what is their prudential rationale?

We are generally supportive of the harmonisation of prudential filters and deductions. However, all Austrian banks still rely on national accounting standards for purposes of calculating their own funds, therefore most filters will have very limited impact.

We acknowledge, and share, the concerns about the inclusion of minority interest in the common equity component of Tier 1. However, to meet these concerns, it would not be necessary to fully and indiscriminately exclude all minorities from Core Tier 1. We therefore suggest a more differentiated approach: If capital received from minorities is directly contributed to subsidiaries which are regulated and adequately supervised credit institutions, there is limited concern that such capital does not effectively support banking risks on a consolidated level (see, for instance, the "institutional" safeguards within the CRD providing for a group-wide risk management and controls within the group of credit institutions). Therefore, minorities should still be included in core Tier 1 if they are provided to regulated credit institutions.

Question 22: We would welcome comments on the appropriateness of reviewing the use of going concern Tier 1 capital for large exposures purposes. In this context, would it be necessary to review the basis of identification of large exposures (10% own funds) and the large exposures limits (25% own funds)?

We are generally open to review the basis of calculation of large exposures and of the limits based thereon. The use of going concern capital as reference might be useful from a regulatory perspective. Any decision on this subject must, however, not be taken before the results of a thorough impact assessment are available. The impact assessment should evaluate the implications on the identification of large exposures and on the limits and should constitute the basis for the definition of a clear and consistent framework.

Question 23: What is your view of the purpose of contingent capital? What forms and triggers would be most appropriate?

We support the introduction of conversion features as a means to establish loss absorption in a stress situation. Its potential role in limiting the societal cost of government intervention and in increasing market discipline should be further explored. Therefore, conversion features are acceptable as a particular technique for loss absorption in hybrids within the boundaries of additional Non-Core Tier 1 capital. Of course, only a fixed conversion ratio could guarantee effective loss absorption. Nevertheless, conversion features by themselves are no reason to disregard the other criteria established for additional Non-Core Tier 1 (e.g. discretionary coupons).

Moreover, it should also be possible to introduce conversion features for Tier 2 capital instruments. However the conversion should be a possible but not a mandatory feature for Tier 2 capital instruments.

Question 24: How should the grandfathering requirements under CRD II interact with those for the new requirements? To what extent should the grandfathering provisions of CRD II be amended to bring them into line with those of the new capital requirements under CRD IV?

Great attention should be paid to sufficient transitional periods so as to allow the industry enough time to adjust to the new regime without suffering undue burden as a result of the regime change. The speed and sustainability of economic recovery after the financial crisis is of decisive importance when determining the appropriate transition periods. The transition regime set out in CRD II might be a useful starting point for discussions on this subject.

During the transition period institutions should be afforded a degree of flexibility to manage and raise capital. Additionally, grandfathering provisions should be carefully considered and must be, in the interest of legal certainty, clearly and precisely circumscribed.

SECTION III: Leverage Ratio

General remarks: We agree that one of the lessons drawn from the current crisis is that size and leverage of financial institutions must be better captured. To address this we generally support the adoption of a non risk-based capital measure (leverage ratio) to supplement and reinforce the current risk sensitive framework in the CRD. We see a leverage ratio as a further (early warning) indicator and as a corrective to restrict excessive balance sheet growth.

Apart from the scheduled calibration given the QIS results, the measure's accuracy to meet the underlying target should thoroughly be reviewed in due course.

Limitations and weaknesses of a leverage ratio:

- Unintended incentives: In the absence of risk-based components, the leverage ratio could give unintended incentives as it does not distinguish between different types of bank assets. This may encourage banks to build up relatively riskier exposures or reduce the scale of hedging instruments. Prudent institutions holding substantial portfolios of highly liquid, high-quality securities and hedged exposures with strong risk management may argue that they are being punished for their conservatism.

- Accounting issues: We fully support the Commission's target of a full adjustment for accounting differences (IFRS vs. US-GAAP vs. local GAAP). In our view a full harmonisation would call for a consistent use of accounting standards for both the numerator and the denominator. For solvency purposes currently all Austrian banks rely on local GAAP to determine their own funds. However, almost all larger banks use IFRS/IAS for accounting purposes. As a result the scope of consolidation differs due to differences in consolidation practices under prudential and accounting requirements.

- Level playing field: The proposed leverage ratio is not neutral in terms of effects on competition. Even if the accounting issue can be solved, the impact on the build-up of leverage will depend on the business model of the credit institution.

- Crisis reinforcing tendencies: if the leverage ratio were made binding, this would have a strong crisis reinforcing effect (forced deleveraging, credit crunch)

Given the limitations and weaknesses of a leverage ratio and the considerable heterogeneity of business models across internationally active banks we prefer an implementation under Pillar 2.

Question 25: What should be the objective of a leverage ratio?

We consider the limitation of excessive growth in terms of the absolute total risk exposure (including on- and off-balance sheet items) as the main policy objective of such a ratio (i.e.

prevent an excessive build-up of leverage in good times). Possible negative impacts (especially in times of crisis) should be avoided (i.e. increased pressure to deleverage in times of stress). This can only be achieved if the leverage ratio is introduced as a flexible measure under Pillar 2.

Question 26: Which element of going concern capital do you consider would be a more appropriate basis for the leverage ratio? What is your rationale for this view?

We support the Commission's intentions with regard to employing a going concern measure of capital in the leverage ratio. We therefore strongly object basing the proposed leverage ratio on an overly restricted definition of capital (i.e. core T1 only). At a minimum, the capital measure in the numerator should encompass Core Tier 1 as well as Non-Core Tier 1 capital components as both absorb losses on a going concern basis.

Question 27: What is your view on the proposed options for capturing the overall extent of an institution's derivatives business in the denominator of the leverage ratio?

Concerning the proposed options for capturing the overall extent of an institution's derivatives business the use of the gross positive fair value appears an appropriate approach given the objective of a simple and non-risk sensitive measure.

Question 28: What is your view of the proposed approach to capturing leverage arising from credit derivatives?

Not allowing netting of derivatives (especially in cases where enforceable netting agreements exist) seems overly conservative but would support the objective of a simple non-risk sensitive and internationally harmonised measure. In our point of view a fully harmonised leverage ratio can only be achieved either by requiring all exposures to be measured on a gross basis, or by specifying a single approach to netting for the purpose of calculating leverage.

Question 29: How could the design of the leverage ratio ensure that it would act as an effective constraint only in benign economic conditions?

Given the design of the leverage ratio (capital vs. total exposure), negative impacts in times of stress will be inevitable. Therefore, the leverage ratio should not be introduced as a binding measure in Pillar 1, but rather as an additional monitoring measure under Pillar 2. Thus, a temporal breach of limit would not lead to crisis-reinforcing tendencies (excessive deleveraging, credit crunch).

Question 30: What would be the appropriate calibration of a leverage ratio?

Due to the wide range of business models there is no “one size fits all approach” of the leverage ratio in respect to its calibration. Structural differences in banks’ balance sheets have to be taken into account.

SECTION IV: Counterparty credit risk

General remarks: In general we agree with the analysis of the Commission. However, the consideration of counterparty credit risk of derivatives in the non-trading book seems to be incomplete. We encourage the reformulation and/or recalibration of the standardized and current exposure method for Credit Counterparty Risk (CCR) in order to keep sound incentives for banks to develop and/or employ CCR models. CCR should be a topic in all banks not only in those with advanced procedures.

Question 31: Views are sought on the suggested approach regarding the improved measurement or revised metric to better address counterparty credit risk. With respect to suggestion to incorporate - as an interim measure - a simple capital addon by means of calculating the loan-equivalent CVA charge, views are sought on the implications of using VaR models for these purposes instead.

We appreciate the move to capture the risk of losses arising from volatility of the PD of the counterparty, as it leads to more conservative behaviour. The proposed solution using a bond equivalent position seems natural and reasonable.

It is however still not clearly stated how banks without internal market risk models should proceed in order to compute the charge in the proposed way and questions remain with regard to the precision of scaling 1d/10d VaRs to a 1y figure. Again, care must be applied in order to assure proper incentives in the decision to use a standardized or an internal model approach.

In addition, we would like to note that the current proposal is pro-cyclical in nature and may increase a major shortcoming of the current regime.

Question 32: Stakeholders are invited to express views on whether the use of own estimates of Alpha should continue to be permitted subject to supervisory approval and indicate any evidence in support of those views.

We are open to a recalibration of Alpha based on potential new insights resulting from the QIS. A general prohibition of own estimates of Alpha can only be a measure of last resort. Instead, a revaluation of the floor should have priority.

Question 33: Views are sought on the suggested approach regarding the multiplier for the asset value correlation for large financial institutions, and in particular on the appropriate level of the proposed multiplier and the respective asset size threshold. In addition, comments are sought on the appropriate definitions for regulated and unregulated financial intermediaries.

We consider this topic to be rather a general credit risk issue (for both IRB *and* standardized approach) and should not be addressed by an isolated CCR amendment.

However, since the potential impact of such a multiplier can be immense we consider strong statistical support for the supposed relationship between institution size/leverage ratio and correlation among assets and a careful calibration of parameters a condition. There is still no quantitative support for the appropriateness of the proposed proxies (size and type of firm) in the long run, not speaking about the concrete (re-)calibration. The results from the ongoing QIS are expected to provide further quantitative evidence in this specific field.

Again, we would like to point out that there is no suggestion how to address the discussed problem within banks using the standardized approach. Furthermore, it must be stated that banks applying the IRB approach not necessarily have an internal rating system in place for “financials”. Therefore, a multiplier for the asset value correlation possibly may only play a role in a very limited number of banks.

Question 34: Views are sought on the suggested approach regarding collateralised counterparties and margin period of risk. Views are particularly sought on the appropriate level of the new haircuts to be applied to repo-style transactions of (eligible) securitisations. In this context, what types of securitisation positions can, in your view, be treated as eligible collateral for purposes of the calculation of the regulatory requirements? Any qualitative and/or quantitative evidence supporting your arguments would be greatly appreciated.

We fully agree with the analysis and support the proposals. Concerning netting sets it remains unclear to what extent these proposals affect banks that have no internal model for the assessment of CCR.

Again, it should be made clear that proper incentives to switch to an internal market model approach should be set.

Question 35: Views are sought on the suggested approach regarding central counterparties and on the appropriate level of the risk weights to be applied to collateral and mark to market exposures to CCPs (on the assumptions that the CCP is run to defined strict standards) and to exposures arising from guarantee fund contributions.

We agree that CCPs should play an important role in the efforts to reduce systemic risk. Therefore, strong incentives should be generated for banks to move exposures to such central counterparties. In the case that CCPs are run according to strict standards, it seems plausible that exposures to CCPs have no (or very little) risk weights.

Question 37: Views are sought on the suggested approach regarding enhanced counterparty credit risk management requirements. Do the above proposed changes to the counterparty credit risk framework (in general, i.e. not only related to stress testing and backtesting) address fully the observed weaknesses in the area of risk measurement and management of the counterparty credit risk exposures (both bilateral and exposures to CCPs)?

We generally support that stress and back testing needs to be pronounced in CCR management, especially for banks using internal models (which usually have comparatively big exposures).

SECTION V: Countercyclical measures

General remarks: Generally speaking, we support both measures to mitigate cyclicality in current regulatory regimes, through-the-cycle provisioning as well as anticyclical capital buffers. We consider dynamic provisioning as a particularly effective measure to dampen cyclicality. We also generally support the concept of capital conservation requirements as this provides supervisors with a standardised tool to enforce the build up of capital buffers. However, the current concept just establishes new minimum capital requirements above the current levels.

For a final assessment, further work is necessary on the precise design of the measures. In our view the conservation buffer and the countercyclical buffer currently share a potential for negative implications in downturns, which should not be underestimated. With this in mind, we suggest to reconsider the proposed measures and seek for more clarity about their impact.

Austrian authorities would welcome further consideration of alternative measures to dampen procyclicality, especially measures that focus on the output of the capital requirements calculation.

Impacts: As the new capital definition already poses a challenge to banks, any additional capital requirement will mean additional efforts to secure appropriate capital levels due to cumulative effects, especially as the introduction of capital buffers will presumably fall into a period of economic distress or at best slow recovery. The one-off implementation costs of building up such buffers should not be underestimated.

Furthermore, potential negative implications on the ability to raise fresh capital when dividend payout is restricted must be considered.

Question 39: Views are sought on the suggested IRB based approach with respect to the through-the-cycle provisioning for expected losses as outlined above.

We generally support basing provisioning on expected losses. The decision by the IASB whether to follow an expected loss approach for calculating provisions is crucial to the implementation of dynamic provisioning.

The current proposal assumes an EL (see page 48, paragraph 144) that is substantially less sensitive to economic conditions than specific provisions. However, this might not always be the case, especially within the context of Point-in-Time Credit Models. We would welcome further work on this issue.

Furthermore, we agree with the current proposal to build the buffer above the line in order to have the anticyclical effect on the balance sheet. Off-balance-sheet items should at the same time be included in the calculation of the provision.

Ad paragraph 148:

- In our experience the downturn LGD differs only slightly from an expected LGD.
- Mergers and acquisitions might substantially affect the overall credit quality of a bank's portfolio. A rudimentary consideration of the credit quality similar to the existing Spanish system of dynamic provisioning should be envisaged.
- As far as the consideration of the portfolio growth is concerned, is there empirical evidence on the effects on portfolio quality?
- The final calibration of the formula including ceilings and floors should be answered with the empirical data of the QIS exercise at hand.
- According to our experience there would be a tendency to higher general provisions for banks in the foundation IRB. The magnitude of this difference is however hard to pin down.

Question 40: Do you agree with the proposed dual structure of the capital buffers? In particular, we would welcome your views on the effectiveness of the conservation buffer and the counter-cyclical buffer, separately and taken together, in terms of enhancing the resilience of banking sector going into economic downturn and ensuring the flow of bank credit to the "real economy" throughout economic cycle.

While we consider procyclicality as an important issue and welcome proposals to dampen or avoid it in future, we fear, however, that several concerns remain with regard to both the suggested capital conservation buffer and the counter cyclical buffer. Currently, the proposed measures effectively establish new minimum capital requirements above the current thresholds (with no anticyclical effect).

When reflecting upon the effectiveness of the measures possible negative effects in a downturn must not be underestimated. In a period of economic distress, a restriction on dividend payout might worsen the situation as the bank might not be able to raise fresh capital from primary markets at affordable conditions.

This problem will be especially hard in the period following the implementation of such a buffer as potential shareholders will anticipate the severe restrictions on dividend payout.

Question 41: Which elements should be subject to distribution restrictions for both elements of the proposed capital buffers and why?

We consider the proposed constraints on distributions as too severe. The suggested calibration would have to be thoroughly evaluated keeping in mind not to disproportionally impede the credit institutions' ability to raise capital on capital markets.

At this stage it is difficult to estimate which effect a capital conservation buffer would have on the mentioned elements of distribution. Before answering this question the results of the QIS should be awaited.

Question 42: What is the appropriate timing – following the breach of capital buffer targets – for the restriction to capital distributions to start? Should the time limits for reaching capital buffer targets be determined by supervisors on a case-by-case basis or harmonised across EU?

The introduction of capital buffers will presumably fall into a period of economic distress in most EU Member States and banks have not been able to build up substantial buffers in the last years. The mechanism of anti-cyclical capital buffering will only work, if banks are given sufficient time to build up these buffers especially in the first few years of application. Only when sufficient capital buffers have been built up should the implementation of restrictions to capital distributions be considered.

Question 43: What is the most suitable macro variable (or group of variables) that may be used in the counter-cyclical buffer to measure the dynamics of macro-level risks pertinent to the banking sector activities?

Suitable macro variables would be: GDP, GDP net government expenditure and individual GDP components (consumption/investments/net exports). In some markets, housing market variables might also be useful. Macro variables, such as GDP output gap or potential GDP, should not be used as they display a high degree of uncertainty.

Question 44: What are the relative merits and drawbacks of capital buffers versus through-the-cycle provisioning for expected losses with respect to minimising procyclical effects of current EU banking regulation?

In our view the conservation buffer and the countercyclical buffer share a potential for negative implications, which should not be underestimated (see Q40). Consequently, Austria prefers the concept of dynamic provisioning as a countercyclical measure.

Generally, Austrian authorities favour a smoothing of capital requirements via the output of the capital calculation. Therefore, we suggest to further elaborate on alternative measures to dampen procyclicality via the output of the capital requirement calculation, e.g. through a time-weighted averaging process.

SECTION VI: Systemically important financial institutions

General remarks: The regulation of systemically important institutions is instrumental to ensuring financial stability. We therefore support the efforts made to develop effective measures to curtail the risks associated with institutions of systemic relevance. In that respect, we would like to stress particularly the importance to pay due attention to the European dimension of SIFI supervision and regulation.

Question 46: What is your view of the most appropriate means of measuring and addressing systemic importance?

The assessment of whether an institution is to be considered of systemic relevance should be based on a pre-defined, harmonised set of criteria. It should not be based only on an appraisal of the size of the institution. Mitigating factors, such as group structures, business models, activities or degree of substitutability should be taken into account when gauging the systemic importance of an institution. The assessment should be regularly reviewed in order to take into account changes to the market configuration and/or firm evolution. We do not support the publication of a list of SIFIs so as to avoid the dangers of moral hazard.

We are not supportive of measures that curtail the size of institutions (notwithstanding competition rules prohibiting the abuse of a dominant position) or prescribe the activities that an institution may exercise.

Question 47: How could the Commission services ensure a consistent prudential treatment of systemic importance across financial sectors and markets?

SIFIs should be required to substantially strengthen their corporate governance and risk management procedures. As it stands today the Basel Framework operates according to the principle of double proportionality: this approach should be further emphasized insofar as SIFIs must have internal risk controls (risk management standards, effective boards and – internal and external – auditing) that ensure the long-term soundness of their operations. Additionally, competent authorities should be empowered to enforce stricter risk management standards. We consider that the efforts made to improve the resolution capacity of SIFIs are essential. SIFIs should be required to put into place adequate resolution and recovery procedures, including living wills. The competent authorities should be given adequate tools to supervise ailing banks and either assist their recovery or allow for a controlled liquidation. The current initiative on developing a European Framework for Cross-Border Resolution should be pushed forward energetically.

SECTION VII: Single rule book

General remarks: We would like to express our support for the harmonisation efforts undertaken so far. However, we want to reiterate our strong concerns with regard to the deletion of national discretions that are rooted in local market specificities or the national legal frameworks, especially where the resulting different treatment does not impinge upon the level playing field.

Question 48: In which areas are more stringent *general* requirements needed given national or other circumstances? Is Pillar 2 a sufficient tool to address *specific* negative circumstances at credit institutions and if not, how could it be strengthened?

Currently, we do not have evidence that more stringent general requirements are needed for the Austrian financial market.

Yes, Pillar 2 is considered a powerful tool to address individual circumstances in credit institutions.

Question 49: What is your view of the suggested prudential treatment for exposures secured by mortgages on residential property outlined above? What indicators and their respective values do you consider appropriate as possible preconditions for the application of the preferential treatment of exposures secured by mortgages on residential property?

We are convinced that the current preferential treatment of exposures fully and completely secured by mortgages on residential real estate is prudent given the strict minimum requirements and valuation rules of Annex VIII. We do support the introduction of a harmonized, conservative LTV-ratio (based on evidence raised by the QIS; in Austria, we in general apply a 60% LTV with the exception of 80% stipulated in the Austrian Building Society Act). Furthermore, it could be considered to set an even stricter limit for F/X financed residential mortgages.

We are also open to the idea of introducing a maximum harmonized Loan to Income (LTI) ratio given that the calculation of the parameters is determined precisely (e.g. deduction of income generated by the underlying property) so that no differences in the way of calculation arise between Member States.

However, with regard to giving the hard test a more prominent role, i.e. introducing it to the treatment of residential real estate collateral too, we would like to raise the following concerns: it is (still) not sufficiently empirical founded; there are huge differences in the calculation methodology and data base between Member States; it generates planning uncertainty and can be pro-cyclical; and it involves high administrative costs on the part of the industry as well as the supervisor (to a lesser extent).

Concerning the IRB-approach (credit risk mitigation) it could be considered to adjust the required minimum collateralization level (LTV of 71.4%) of the exposure.

Question 50: What is your view of the suggested prudential treatment for exposures secured by mortgages on commercial real estate outlined above? What indicators and their respective values do you consider appropriate as possible preconditions for the application of the preferential treatment of exposures secured by mortgages on commercial real estate? In particular, are additional preconditions needed to ensure the soundness of this treatment? Do you believe that the existing preferential risk weight applied to exposures secured by mortgages on commercial real estate should be increased?

We are convinced that the current preferential treatment of exposures fully and completely secured by mortgages on commercial real estate is prudent given the strict minimum requirements and valuation rules of Annex VIII. As to the recalibration of the LTV ratio or the preferential risk weight (which we would be rather reluctant to change) we expect the QIS to produce valuable input (as to the hard test, please see above, Q 49).

Question 51: Should the prudential treatment for exposures secured by mortgages on residential property be different from the prudential treatment for exposures secured by mortgages on commercial real estate? If so, in which areas and why?

If the hard test were introduced to the treatment of residential real estate collateral too, there should be no differences in terms of limits, i.e. the loss limits given in Annex VI, Part 1 point 58 should also be relevant for the assessment of the real estate market. However, the current differences concerning risk weight and LTV-ratio should be maintained.

Question 52: What is your view of the merits of introducing measures that would help to address real lending throughout the economic cycle? Which measures could be used for such purposes? What is your view about the effectiveness of the possible measures outlined above?

To avoid procyclicality and react in time to a possible overheating of the real estate market we would support a fixed automatism to the adaption of the LTV ratio. However, again, a precise methodology needs to be determined.