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Responses to the Commissions Working Document „Consultation regarding further possible changes to the Capital Requirements Directive (CRD)

I. Liquidity standards:

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 underlying purpose is to get banks prepared to overcome an acute 30-day stress scenario on their own. The LCR consolidates many relevant stress scenarios and stressed cash flow assumptions respectively into a single metric. As a consequence, one the one hand, the combined stress assumptions are utmost conservative. On the other hand, most factors applied to on and off balance sheet items could be observed during the financial crisis, though not always simultaneously in one institution. Thus, irrespective of whether evidence can be found for specific factors on an individual basis, the overall calibration of the LCR may prove unbearable for many banks in terms of the business models. This is e.g. true for the treatment of inter-bank exposures where the assumptions are most extreme.

In general banks will be required to hold on their balance sheets more stable and more expensive funding and/or extend their holdings of highly liquid but less profitable assets. In view of tight margins in banking business, institutions will be forced either cutting back their balance sheets or passing on the increased costs to clients despite of competitive pressure.

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 our perception, the LCR should be designed to ensure that banks hold sufficient highly liquid assets to survive a severe liquidity shock without the need of any public aid, especially extraordinary borrowings from the central bank. Under these considerations, certain high quality corporate and covered bonds should also be eligible for the buffer. Furthermore, we think that additional assets may justify inclusion into the liquidity buffer. In particular we recommend taking into account bank debt securities fully guaranteed by sovereigns or respectively securities of promotional banks under public ownership to be eligible for the buffer, as the best-quality guarantor should be the determining factor when assessing the high-quality liquidity of an asset (except of guarantees granted in terms of extraordinary public interventions such as financial rescue schemes since 2007/2008). Central bank eligibility may be an indicator in this regard, but it should not be the predominant criterion when assessing the liquidity of an asset. In fact it has to be supplemented by the marketability of the asset. That means eligibility to the liquidity buffer should particularly based on the objective to liquefy assets under severe stress conditions in private markets. Therefore in our view it is not an imperative to establish central bank eligibility as being mandatory for the buffer assets. Thus the regulators' list of high-quality liquid assets should not depend on central bank policy and potential decisions of modifying (shortening/extending) the central bank's list of collateral.

At all events, we suggest – as indicated in paragraph 7 – analysing eligibility of assets further in the context of European specifications. Rather than to compose a specified list the Commission should identify certain indicators resulting in a common understanding of high-quality liquid assets (which may differ from the list established by central banks) and should be applicable to all European banks in order to cover short-term liquidity stress when it occurs suddenly without assuming or anticipating the assistance of central banks or government support in advance. However, instead of developing binding technical standards, the EBA should draw up a general principle based proposal to the Commission which could be recognised in the elaboration of the legal text.

Moreover, we believe it is necessary to examine and confirm whether the criteria for the additional assets regarding bid-ask-yield spreads (in conjunction with certain haircuts) and the required ten-year time series are practicable or whether meeting the conditions might not be possible because of a lack of data. We recommend that the Commission address these questions thoroughly before putting this proposal into final law.

In addition, we suggest reviewing closely the modification of certain determinants which we regard as overly restrictive. This could be done with the help of the current QIS (e.g. the proposed 50:50 relationship between assets of the narrow buffer and additional assets could be modified to 30:70 or there could be no limitations at all) in order to align the definition of high-quality liquid assets more closely with realistic assumptions. Being in agreement with the Commission, we also propose that such considerations be handed over to an expert group for analysis.

Regarding the denominator of the LCR net cash outflows over a 30-day time period, it could be reasonable to investigate on the basis of the results of the QIS whether the proposed factors for calculating cash outflows are realistic in reflecting the European banking sector. Furthermore, consideration should be given to whether the classification as stable and less stable deposits is appropriate in view of the fact that saving accounts, one of the most stable sources of funding, are categorised as less stable. Thus, the cash flow structure of more simply structured banks, in particular, should receive close consideration when evaluating the suitability of the LCR.

We agree with the Commission's proposal in paragraph 9 that the trade-off between the severity of the stress scenario and the definition of the stock of liquid assets should be analysed thoroughly. Having said that, we also agree with the Commission that the final calibration of the outflow and inflow percentage factors and the stock of liquid assets should be sufficiently conservative to create strong incentives for institutions to maintain prudent funding liquidity profiles while minimising undesirable side effects.

Both components of the LCR should be based on credible assumptions reflecting the rather heterogeneous European banking sector, thus preventing an unbalanced and disproportional burden on certain participants of the banking sector.

Especially the design of the LCR aims for a complete coverage of a severe, but at least simulated stress scenario which is reflected by the degree of detail in quantitative specifications and by rather conservative restrictions in parameters and factors. Even though the banking sector achieves effective/ successful compliance with the standard, this stress scenario will still not be able to fully prevent the next financial crisis and, simultaneously mirror potential consequences for liquidity risk and funding sources at institution-specific and sectoral levels or beyond. The LCR has to be supplemented by adequate internal liquidity stress testing taking into account other relevant and severe stress scenarios.

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.

(Question for market participants only).

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.

We also suggest that the Commission should consider the cost of adjustment (at least the possibility of adjustment at all) of the long-term funding structure to comply with the standard (sensitivity). In addition, the Commission has to take into account whether the NSFR created incentives to substitute positions under the one-year horizon to a one-year-plus-one-day horizon ("cliff effects"). As regards quantitative evidence we are largely dependent on the insights out of the QIS. So far, there are indications that the calibration of the NSFR may be overly restrictive in terms of "traditional banking business" such as retail lending compared to investment banking activities, e.g. such as securitisation. Furthermore, there are some inconsistencies with regard to the treatment of accruals and deferrals, intangibles and deductions of the regulatory capital. Finally, the undifferentiated treatment of the considerable number of items assigned to the "Other assets"-category with a 100% RSF-factor may be inappropriate and overly restrictive.

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?

There is no doubt that such a different treatment always implies potential reactions of escaping by institutions However, as we already have stated in terms of question 4, we would deem it inappropriate to further tighten the RSF-factors for "traditional banking business" such as loans, including those with a residual maturity of less than one year. Furthermore, we have to bear in mind that the NSFR is not intended to enable banks to merely sit out a stress situation. Instead, the NSFR shall provide banks with sufficient time to adjust their business to a protracted period of stress. This may involve the decision to cut back the loan book.

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 ASF-factors should strengthen the demand on retail deposits, once the central banks will reduce the abundant liquidity. The same should be true for long-term wholesale funding. Both retail customers and providers of long-term wholesale funds would benefit from intensified competition for stable funds, whereas especially short-term interbank lending would be less attractive (for both lenders and borrowers). The increased competition will probably make retail deposits less stable. Overall, the funding costs should increase which may affect all clients in terms of higher prices for and/or reduced supply in financial products.

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?

We do not agree with the proposal to set out in legislation all national specifications and therefore all specific categories e.g. of retail deposits. As the proposed ratios are to be seen as minimum requirements it should be decided case-by-case for the respective jurisdiction. Actually we are concerned that such an intention might lead to stricter requirements introduced through the back-door. Moreover, we see no advantage in setting Technical Standards such as timely updating is not facilitated but removed from legal responsibility.

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.

The Commission should certainly reassess the classification of stable and less stable retail deposits. Several criteria that partly have to be fulfilled cumulatively by deposits do not reflect business practices in some EU jurisdictions and thus are difficult to be applied in a meaningful manner by supervisors. Saving accounts e.g. as one of the most stable sources of funding are categorised as less stable.

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.

We agree with the proposal in paragraph 17 to grant the provision of a waiver for the single entity level. In our view, a sophisticated group-wide liquidity management should be the key criterion for allowing banks to waive from the single entity application of the liquidity standards.

We welcome the proposal of a cross-border waiver. We agree with the proposal that, in cases of disagreement, the supervisors of the subsidiaries in question would take the final decision as to whether each subsidiary should be subject to liquidity standards on a stand-alone basis in addition to the consolidated level.

As a conclusion, there should be no need to call the EBA to settle a disagreement.

The Basel framework, which forms the foundation of the Commission's requirements, is intended, primarily, for large internationally active institutions. The Commission, in contrast, is aiming for a harmonised liquidity standard which should apply to all types of credit institutions, regardless of size or business model. The QIS will include data from different types of institutions, including small and medium-sized banks. The situation of the smaller banks should be taken into due consideration when drawing up the final proposal and in the implementation of the EU liquidity regulations.

In our view the European Commission should verify that the terminology in paragraph 17 of the Commission's consultation paper might be applicable to banking groups with decentralised structure, given that the conditions for granting an exemption from the application of the standards at the level of legal entities are met.

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 consolidated liquidity requirements of a banking group even if not subject to stand-alone liquidity standards (i.e. financial institutions or 50K or 125K 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?

(Regarding Q. 10 and 11) The scope for the stand-alone liquidity standards should comprise no others than credit institutions and investment firms whose liquidity risk and role in the financial system requires such a treatment. The necessity to impose the new standards on other institutions should be assessed on a case-by-case basis. Regarding entities to be consolidated, only firms being subject to stand-alone liquidity standards should be included in the scope of consolidated liquidity requirements.

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.

In particular, we appreciate the approach described in paragraph 23 of the CP, with a possibility for supervisory authorities to honour intra-group transactions. This approach assumes that, even under severe stress, group entities would roll over their intra-group loans and deposits and could draw upon legally binding commitments from other group entities. This is in line with an ongoing group-wide liquidity management even under stressed conditions, including pooling of liquidity and where solo entities are given the possibility of drawing on centralized liquidity pools. Instead, paragraph 22 assumes that intra-group relationships are significantly compromised and is thus designed to manage rather than to avoid a crisis.

In our view the European Commission should explicitly state that the terminology regarding the treatment of intra-group transactions and commitments might also be applicable to banking groups with decentralised structure taking into account the strong interrelation between central institutions and local banks in case of a durable funding network and joint guarantee systems of the group. This is to avoid discriminating against certain legal forms of credit institutions.

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?

We agree with the Commission’s view that, with the introduction of a uniform liquidity standard in the EU, the host responsibility for liquidity supervision for foreign branches should be redundant. Therefore, we welcome the Commission’s initiative which assigns the supervisory responsibility for foreign branches to the home member states and abolishes separate liquidity standards.

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 also sought on the individual tools listed in Annex III, their quality and possible alternatives or complements.

We welcome the introduction of harmonised monitoring tools. Owing to their flexibility, timely updating and transparency, such monitoring tools should be part of the supervisory review and not included in a mandatory supervisory reporting framework. Such monitoring tools could be provided in a standardised format for regular information exchange within supervisory colleges. Therefore, CEBS has developed the “liquidity identity card”.

Question 15: What could be considered a meaningful approach for monitoring intraday liquidity risk?

With regard to the treatment of intraday liquidity risk, we firmly believe that this issue is covered sufficiently in the Commission’s qualitative requirements (Annex IV). In our opinion, the development of technical standards to cover this issue would be an inappropriate burden for credit institutions that implies only little, if any, additional value for supervisors. Instead, quantitative standards for intraday liquidity risk imply the risk of double regulation as it touches credit risk and operational risk issues. Moreover, minimum requirements for intraday risks may undermine the assumptions of the LCR (e.g. 100% inflows from fully performing loans). From a quantitative point of view, banks that comply with the LCR can be considered prepared to handle with potential intraday issues without compromising the smooth functioning of payments systems.

II. Definition of Capital:

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?

The idea of simplifying the regulatory capital structure indeed seems reasonable. The borderline between hybrid tier 1 instruments and upper tier 2 has become increasingly blurred. Therefore, we welcome the intended clearer separation of the different classes of regulatory capital along their newly defined objectives (going concern vs. gone concern capital).

As regards tier 3 capital, we agree with the proposed elimination of it. Experience has shown that this capital class often was filled only with capped additional own funds. In our view, the capital requirements for market risks in the future should not be met in any other way than is required for credit and operational risks.

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?

Criteria for Core Tier 1

We strongly advocate a definition of regulatory capital which is neutral to the legal form of banks. This approach, which was also taken in the course of the CRD II revision of the own funds rules of the Banking Directive, proved to be a sensible way forward and was also strongly supported by the industry.

The CRD IV consultation paper now takes a different approach as paragraph 42 limits future core Tier 1 instruments of joint stock companies to common shares. We are concerned that this approach may cause competitive distortion between legal forms of institutions and might also be in conflict with the principle of equality of treatment. We propose to opt for a legislative approach which defines core Tier 1 for all institutions in a principles based way along the lines of loss absorption, permanence and flexibility of payments without reference to any specific instruments and which is neutral to the legal form of institutions.

Additionally, CRD II introduced through its recital 4 the possibility to also include into Core Tier 1 instruments with preferential rights for dividend payments. We hold the view that the question how earnings are distributed between different capital providers is an issue for the institution' s owners to decide upon but does not need to be addressed through regulatory rules. We therefore think that the flexibility provided for in CRD II should be maintained in this respect and criterion seven of Annex IV of the consultative document needs to be revised accordingly.

Criteria for Non-Core Tier 1

The crisis has shown that the capacity of regulatory capital to absorb losses is most important – but was missing in many cases. As loss absorption in our view should be the key criterion for the recognition of regulatory capital instruments, we strongly support the Commission's intention expressed in paragraph 52 of the consultation paper to require an effective mechanism for loss absorption for all non-core Tier 1 instruments.

With the entering into force of the new CRD II rules on hybrid capital, a Tier 1 hybrid instrument's principal, unpaid interest or dividend will all be required to be loss absorbing and not to hinder recapitalisation. CEBS´guidelines on hybrid capital spell this out in more detail. The requirements to be drafted under CRD IV should not fall behind the already achieved improvements in the quality of regulatory hybrid capital. In contrast, the proposal from the Basel Committee's consultative paper

"Strengthening the resilience of the banking sector" to distinguish between such instruments that are classified as a liability for the purposes of national insolvency law and such instruments which along these lines can be regarded as equity seems arbitrary and lacking justification as regards content.

Equally, we fully agree to the Commission's standpoint of considering additional eligibility requirements with regard to the tax treatment of hybrid instruments as not necessary.

As regards payment flexibility, we do not consider it necessary to require an institution to have "full discretion at all times". Instead it should suffice to keep the wording that CRD II uses in Article 63a (3) and require the institution to cancel the coupon/dividend payment whenever necessary. This in our view should provide a certain safeguard for investors against arbitrary decisions taken by the bank. Unlike common shareholders, hybrid investors cannot decide themselves about whether the coupon will be paid. Not leaving "full discretion" to the banks could help to prevent the risk of putting the investors at a certain disadvantage.

Criteria for Tier 2

Germany has made use of the national discretion provided by Articles 57(g) and 64(1) of directive 2006/48/EC to take in account the uncalled commitments of the members of cooperative credit institutions. Currently, section 10 (2b) no. 8 of the German Banking Act stipulates that the additional own funds also include the additional sum to be set by way of a regulation by the Federal Ministry of Finance to take account of the uncalled commitments of members (set at 25%). In practice, these commitments are the second most important contribution to the tier 2 capital of cooperative banks.

In general we accept the prudential rationale to no longer accept forms of capital that have not yet been paid up. However, in order not to overstrain cooperative institutions, appropriate grandfathering rules will be indispensable. Additionally, a gradual phasing-out over time should also be considered.

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?

In our perception, to require the write down of the principal amount of an instrument or its conversion under certain circumstances is the only way to achieve that losses (exceeding certain dimensions) are absorbed effectively.

In order to make it transparent and more predictable for investors and other market participants, we favour a trigger which is pre-specified and objective but which should be negotiated between the issuer and the investor. This should be backed however, by the right of the competent authority to trigger the loss absorption mechanism as deemed necessary. CEBS' guidelines for hybrid capital instruments which state that the supervisor should be able to trigger loss absorption at the latest when a breach of the minimum capital requirements is about to happen, in this context could serve as a benchmark.

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?

The Commission proposes that prudential filters and deductions be applied at the level of common equity. In consideration of the proposed revision of the regulatory capital structure we see no justification for limiting the basis for taking the deductions to Core Tier 1 capital only. If all Non-Core Tier 1 instruments in the future also will have to be truly loss absorbent on a going concern basis as proposed by the Commission, we deem a deduction from common equity only to be unduly conservative. This is especially true for goodwill and deferred tax assets – deductions that we expect to have the greatest impact on the German banking sector. In our perception, these items could just as well be covered by deductions from total Tier 1. However, further issues may arise during the analysis of the results of the QIS.

Additionally, for deferred tax assets a materiality threshold should be envisaged as a full deduction might well lead to additional unwanted procyclicality in the definition of own funds.

Furthermore, we strongly recommend considering a gradual phasing in of those prudential adjustments that will have the biggest impacts over time.

Question 20: Are the proposed requirements in respect of calls for non-Core Tier 1 and Tier 2 sufficiently robust? Would it appropriate to apply in the CRD the same requirements to buy-backs as would apply to the call of such instruments? What restrictions on buy-backs should apply in respect of Core Tier 1 instruments?

Yes, we consider the requirements that the Annexes VI and VII set out in respect of calls to be sufficiently robust. CEBS´guidelines on hybrid capital may serve as source for further orientation for how the subject of call options could adequately be addressed.

As regards buy-backs, we do see some similarities to the exercise of a call. However, we do not view them as entirely equivalent in every respect. Unlike in the case of a call, in order to be able to undertake a buy-back, banks need to find investors who are willing to sell the instrument back to them.

Therefore, subject to supervisory approval, buy-backs should be permissible before the end of the five year-period after the issue date. This is requisite in order to preserve the flexibility that is indispensable for banks´capital management.

Additionally, the rules to be set out need to take account of the needs for market making.

Question 21: What are your views on the need for further review of the treatment of unrealised gains? What would be the most appropriate treatment of such gains?

We strongly support the Commission's consideration to remove unrealised gains from core Tier 1. In our view, the recognition of these gains will lead to a high volatility in regulatory capital which might lead even to increased procyclicality in the definition of regulatory own funds.

The respective accounting standard, IFRS 9, is still under discussion. We should not pre-empt the outcome of this debate but rather await the result. For the time being, we would deem it best to remain with the currently applicable rules (recognition as Tier 2 only, with a haircut) as they have proven reliable.

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 limit (25% own funds)?

Currently we do not see any need for a revision of the large exposure rules, which have only recently been amended with CRD II. Such measure would disproportionately hit smaller institutions which did not cause the financial crisis and continued to extend credit to the real economy during the crisis.

Even if the aim of the Commission was to change the reference point for large exposures in a neutral way (i.e. through a corresponding increase in the limits for large exposures), we still advocate for maintaining the current rules as this change would not lead to a better regulation but would only cause administrative burden for institutions.

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

The purpose of contingent capital should be to provide an additional safeguard or extra capital cushion that can be relied on in times of severe stress (firm-specific). Generally speaking, the concept of contingent capital should leave the eligibility criteria for the different categories of regulatory capital unchanged. Nevertheless, the recognition of some kind of supervisory benefit is entirely conceivable, e.g. for stress test purposes under pillar 2.

The trigger should be defined in dependence of the still to determine concrete objectives.

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?

The grandfathering requirements to be foreseen by CRD IV should not fall behind what has already been adopted under CRD II. The legislative process for the changes to the Banking Directive as foreseen by CRD II has been closely observed by the industry; the rules will soon enter into force. There is a need to protect legitimate expectations that have already been built up.

Furthermore, it should be considered extending the grandfathering across all classes of the regulatory capital structure and to all capital instruments which under the new CRD IV rules will no longer be eligible.

III. Leverage Ratio:

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

We principally do oppose the introduction of a binding leverage ratio.

However, the objective of the leverage ratio should be to avoid a forced reduction of leverage, which has been an issue during the crisis and should be prevented as far as this is possible without preventing institutions from fulfilling economically necessary tasks such as term transformation, risk transformation and size transformation.

To achieve this goal, a meaningful definition of the leverage ratio is important. In the following paragraphs, we highlight potential problems with the current design of the leverage ratio. Although we recommend adjusting the working definition of the leverage ratio, we do not expect that even a revised leverage ratio would meet the desired objective.

Trying to achieve this aim by making the proposed leverage ratio binding would be literally out of the frying pan into the fire. Had this leverage ratio been binding during the crisis, the losses made during the crisis would have forced institutions to reduce their leverage even more than they have already been forced for coping with the risk-based minimum capital requirements.

This becomes obvious by considering the impact of losses on the proposed leverage ratio. Any Euro lost on a certain asset or any adverse value adjustment would reduce to the same extent both the capital in the numerator and the accounting value in the denominator of this leverage ratio. This, however, would unavoidably result in respective deterioration of the leverage ratio. A binding leverage ratio would therefore not prevent institutions from relatively high leverage under benign economic conditions but would force institutions to reduce their leverage just in times when higher losses or deteriorated asset values reduce their capital. This is caused by a faulty design of the proposed leverage ratio, in particular because of following the accounting treatment by sticking with existing capital under current economic conditions instead of taking into account in advance expected and unexpected losses under adverse economic conditions, and by using fair values of derivatives and using accounting values of assets net of value adjustments.

We strongly oppose to amplifying the risk of a credit crunch during times of high losses by introducing the proposed design of leverage ratio as a binding measure.

We admit that the risk-based minimum capital requirements are prone to a similar effect. Where losses or value adjustments have reduced the capital and/or heightened risks have raised the capital requirements, the risk-based minimum capital requirements could also force a reaction. However, unlike the leverage ratio, the risk-based minimum capital requirements do not necessarily force an institution to reduce its leverage but allow alternatively reducing the denominator by requiring collateral from customers, by legally enforceable netting agreements or by transferring risk to third parties via collateral, guarantees, credit derivatives or synthetic securitisations.

Unlike this, making the proposed leverage ratio binding would not only leave no alternative to forced reduction of leverage in case of losses or adverse value adjustments but even prevents from risk mitigation because collateral received would count as an additional asset and would therefore increase the denominator, and a premium paid e.g. for receiving a guarantee would reduce the capital of the institution and would therefore decrease the numerator without decreasing the denominator. This again demonstrates that the proposed leverage ratio has a faulty design because it does not take into account risk mitigation effects.

Finally, we wish to highlight that reduction of leverage was in important cases not forced by losses but by the drying of refinancing sources, e.g. where investors unexpectedly abstained from reinvesting into commercial papers on securitised sub-prime mortgage portfolios or where credit institutions did no longer lend to each other because of concerns about hidden loss risks of other credit institutions, which caused a collapse of the inter-bank market.

Therefore, a leverage ratio defined in a meaningful way should take into account the sources of refinancing an institution is dependent on. The design of a leverage ratio as proposed by the commission completely ignores this question and therefore results in an inappropriate limitation to the extent that institutions have no maturity mismatch because of long-term refinancing or rely on stable refinancing sources like central banks. The design is also faulty because it does not take into account to what extent financed risk positions could turn out to be of higher risk than expected such that investors could no longer be willing to prolong refinancing.

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

All elements of going concern capital can be taken into account, because all of them are able to absorb losses going concern and therefore decrease the need for refinancing by borrowed funds. Therefore, Tier 1 would be appropriate and core Tier 1 only would be too conservative.

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?

The need for refinancing derivatives increases with increased replacement costs. Therefore, any approach for calculating the exposure value of derivatives under the risk-based minimum capital requirements should also be available for calculating the overall extent of an institution’s derivatives business. Sticking with fair value is inappropriate because this only accounts for current replacement costs and ignores that this replacement costs, and as such the need for refinancing, could increase in the future. Netting of derivatives should be allowed in case of enforceable netting agreements, i.e. under the same conditions and in the same manner as under the risk-based minimum capital requirements, because in this case the need for refinancing the total derivatives exposure to certain counterparty is limited to the net exposure.

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

Only digitals require the protection provider of a credit derivative to pay the full notional amount which could require refinancing from third parties where own funds are not sufficient. Therefore, for digitals it is correct to capture the full notional amount.

In any other case, the protection provider receives the protected obligation itself or the proceeds from the protected obligation such that this protection provider has no need for refinancing the full notional amount but only for refinancing the loss in case of default of the protected obligation. Therefore, only the risk-adjusted amount, i.e. expected loss plus unexpected loss need be captured by the leverage ratio. For this, it is sufficient to capture the sum of regulatory EL (in case of Standardised approach by using the implicit PD derived from the risk weight and the regulatory LGD) and the risk-weighted exposure amount.

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

This is impossible where a leverage ratio is based on comparing capital with exposure amounts. Higher losses during adverse economic conditions will reduce capital and will therefore result in deterioration of this kind of leverage ratio (by reducing both numerator and denominator) such that it becomes binding rather in adverse economic conditions where it has not yet become binding in benign economic conditions.

Since this kind of leverage ratio is correlated with the movement of the economic conditions in a similar way as the risk-based minimum capital requirements, the only reasonable goal could be dampening the cyclical movement in the same manner as for dampening the pro-cyclical effects of the risk-based minimum capital requirements.

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

The proposed design of a leverage ratio prevents from any reasonable calibration.

This leverage ratio should never become binding at the moment when the risk-based minimum capital requirements have already become binding for an institution because then it would prevent the institution from using risk mitigation and would therefore force to reduce leverage.

Technically, this could only be ensured by either calibrating the leverage ratio at 1 to prevent any leverage from the outset or by calibrating the leverage ratio at 0 to prevent from the outset that the leverage ratio becomes binding.

Any other calibration does not ensure that the leverage ratio does not step in when the risk-based minimum capital requirements have already become binding and could therefore force to reduce leverage instead of preventing institutions from being forced to reduce leverage.

IV. Counterparty Credit Risk:

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 add-on by means of calculating the loan-equivalent CVA charge, views are sought on the implications of using VaR models for these purposes instead.

The inclusion of a stress period to the observation period for the EPE is considerable improvement. The current exposure method (CEM) and the Standardised measurement method (SMM) will have to be recalibrated in accordingly.

One essential requirement for the use of the Internal Models Method that is, however, not explicitly mentioned in the current rules text is that institutions should account for the potential “jump to default” as well as non-default rating migrations of issuers (3rd party names occurring in the portfolio via e.g. CDSs and SFTs) of the underlying exposures. This needs to be added. (In Germany this is already a requirement on institutions.). The CEM and SMM need to be re-calibrated also in this respect.

The bond-equivalent CVA charge falls short of recognising that the replacement cost of a netting set may rise beyond the current exposure amount. To be a truly pragmatic alternative for the short term, one might consider determining the CVA charge using a concept that already exists in the CRD, e.g. the SA or IRBA risk weights may be increased for CCR exposures. This RWA increase should be determined in a risk-sensitive way to the extent as practically possible.

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 agnostic about whether alpha remains open for own estimation. Own estimates are in principle desirable as they have to potential to increase risk sensitivity. The use test seems to be rather weak with respect to own estimates of alpha.

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 have concerns about the suitability and reliability of the data used for the calibration of the AVCs, not all analyses performed by the BCBS showed the need to increase the AVC values above 24%. Therefore, we should not change the current level of the AVCs without further analysis in this area. Furthermore, if it was still decided to increase the AVCs for "large financial institutions", we propose that the threshold should be set at a level that ensures that only systemically relevant institutions are captured by this threshold (e.g. the threshold could be set at 100 billion Euro).

With respect to definitions for regulated and unregulated financial intermediaries we recommend to rely on definitions that are already enshrined in an EU Directive (i.e. alternative investments).

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.

The suggested changes are acceptable.

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.

The suggested approach is acceptable.

Question 36: Views are sought on the risk management elements that should be addressed in the strong standards for CCPs to be used for regulatory capital purposes discussed above. Furthermore, stakeholders are invited to express their views whether the respective strong standards for CCPs to be used for regulatory capital purposes should be the same as the enhanced CPSS-IOSCO standards.

The suggested approach is acceptable. It is important to achieve a level playing field for CCPs in any respect as their business is particularly globalised. Therefore the EU should adopt the enhanced CPSS-IOSCO standards once they are available.

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)?

The suggested approach is acceptable.

V. Countercyclical Measures:

Question 38: The Commission services invite stakeholders to perform a comparative assessment of the three different methods (i.e. ECF, incurred loss and IRB expected loss if it could be used for financial reporting) for credit loss provisioning from 2002 onwards based on their own data.

We do generally support the introduction of an expected loss-approach, which is based on current estimates of credit risk and not tied to strict trigger events (like the current Incurred Loss model of IAS 39). The expected loss approach would mean building up credit risk provisions at an earlier stage of the credit/business cycle and therefore lead to a more realistic picture of credit risk evaluation and management processes in accounting („true and fair view“). Although this approach would also be cyclical, in particular if there are subsequent changes in the estimates for cash flows which take account of changes in expected losses, it should normally be less cyclical than the incurred loss approach.

In addition, the Commission proposes the introduction of a „countercyclical buffer“ which follows an “over an economic cycle“-approach and aims at further strengthening financial stability by building a buffer in good times in order to let it be drawn down in bad times. We welcome this overall objective, however we think this is difficult to achieve within the accounting framework („above the line“). It may be more feasible to implement such a buffer without interfering with valuation methods by introducing a special reserve unavailable for distribution („economic cycle reserve“ as proposed by the „Turner Review“ in March 2009) or directly through regulatory requirements.

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 the idea to allow IRB-banks the use of internal data for the calculation of expected losses. This may help to provide a solid data basis for this approach, lower the implementation cost for banks while at the same time aligning provisions with the individual risk situation of the bank. It should be stressed that allowing the use of internal data does not mean allowing the use of internal models. The latter is highly problematic, because it impairs comparability between institutions and raises level playing-field concerns. Instead, we would advocate developing a largely non-discretionary, formula-based approach.

We further support the suggestion to exclude provisions (whether specific, general or dynamic) from regulatory capital as these are built for expected losses and should therefore be covered by the business operations. Regulatoy capital serves as buffer for unexpected losses instead.

Irrespective of the final design of a „dynamic provisioning“-system, it would be – in our view - appropriate to delay the decision about the introduction of such a system until the finalisation of phase two (Financial Instruments: Amortised Cost and Impairment) of the IAS 39 replacement project by the IASB. In case of further need for action, a supplementary measure should be established in the regulatory framework; this would provide for a level playing field and help to avoid an otherwise needed further amendment of the international accounting standards (“carve in”) to be used inside the EU.

Full transparency of an „expected loss provisioning”-model based on a through the cycle approach could be achieved by corresponding disclosure requirements.

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.

We agree to the overall concept of counter-cyclical measures.

However, the current proposals on the **capital conservation buffer** do not reflect the intended way forward. The fixed target approach does not effectively counter the cyclical effects. In an economic downturning, it may even boost cyclical effects as the fixed target has to be seen as a new minimum capital requirement. Every institution has to withstand the use of the buffer, otherwise the markets will know of at least the troubles an institution might have.

The **counter-cyclical buffer** with an intelligent combination of macro-economic variables can be the right measure to address pro-cyclicality. We support an only counter-cyclical buffer without using a fixed target. The Basel Committee is currently working on different sets of macro-economic variables. Therefore, we would be in favour to interrupt the European regulatory process until an acceptable, reliable and tested proposal is on the table. As we are still in a severe crisis, there is no need to speed up the regulation in this field.

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

All elements mentioned in paragraph 160 should be discussed and tested against the national regulations. The level playing field of usable earnings is as essential as the use of discretionary bonus payments. The build up of the buffers for the first time as well as after having used it in times of stress must be manageable without any state aid.

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?

In general, we prefer a harmonised timing to be discussed after the final regulatory proposal has been prepared and carefully tested. However, there might be cases where individual approaches help an institution to survive compared to a given insolvency when timing is strictly required.

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?

> We feel that the credit to GDP gap should be one variable. In addition to this a short-term variable (following the market in very short time distance) should increase the sensitivity of the measure, e.g. credit spreads. The growth of credit might be one. Other Options are just discussed in the Basel Committee's Macro-Variables Task Force. In reference to this we refer to our response to Question 40.

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?

> Capital buffers will not only address credit business, but other business as well. So a broader coverage of risks is automatically reached. As long as the European financial market philosophy is closely linked with wholesale banking, the proposal should not only cover credit risk. Moreover, credit risk -in our understanding- is best addressed by through-the-cycle provisioning.

Question 45: Do you consider that it would be too early to fully assess the cyclicality of the minimum capital requirement?

> We believe that the capital requirements are cyclical. This exercise should be undertaken to dampen cyclicality. Therefore, we support all efforts to carefully consider counter-cyclical measures in its effectiveness and timing.

VI. Systemically Important Financial Institutions:

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

> At the current stage, many of the proposed measures are already addressing systemic important banks more than others. In our opinion these measures should be reflected in conjunction with the QIS. If there were gaps in regulation concerning systemic important institutions, further steps towards must be taken. In addition to these measures and to be implemented at once, appropriate management procedures and supervisory structures should be required.

Models to measure systemic importance are still in their infancy and not suited to tie supervisory policy measures to it. Therefore, the most promising way at this point in time is to develop an indicator based approach based on the dimension “size”, “interconnectedness” and “substitutability”. However, meaningful results can only be attained if the existing substantial data gaps can be closed. The BCBS is currently working on this. The EU should await the results. Furthermore, a convincing aggregation method of the used indicators needs to be found. Here also work is underway.

We advocate a mix of supervisory policy option to deal with systemic importance. They should preferably be implemented as Pillar 2 solution to allow for the necessary flexibility to use pragmatic approaches and to integrate qualitative supervisory evaluation. Supervisory guidance has to be developed in this context to guarantee a level playing field under Pillar 2. In our view, the supervisory policy mix should incorporate stricter risk management requirements and the implementation of a cross-border large exposure regime and take into account the effects of the already decided additional requirements in the Basel consultative document from December 2009.

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

The EU approach could follow the lines of the IMF/BIS/FSB-paper “Guidance to Assess the Systemic Importance of Financial Institutions, Markets and Instruments“ from October 2009, which responds to a call by the G-20 on the IMF and the FSB to produce guidelines for national authorities to assess whether a financial institution, a market, or an instrument is systemically important. The IMF proposes to assess systemic importance in all three areas by the dimensions „size“, „interconnectedness“ and „substitutability“. The assessment of these three criteria should be complemented with reference to financial vulnerabilities and the capacity of the institutional framework to deal with financial failures. High-level principles (incorporated in the supervisory review process (Pillar 2)) could be used to allow for individual judgment of national supervisors and to include national financial frameworks with the objective to facilitate a consistent implementation across countries. These high-level principles could be made more formal once experience is gained.

VII. Single Rule Book:

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?

Before the option of gold plating will be deleted it has to be assessed whether the current rules adequately address existing risks in all cases.

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?

The local markets for RRE are still characterised by different market conditions. In light of the particular importance of RRE financing it has to be ensured that national peculiarities can be considered by using the currently existing options in the CRD. In this respect, the option to recognise RRE should not be linked to a hard test which has to be applied uniformly by all Member States.

The practicability and benefit of the proposed „Loan to Income ratio“ seems to be highly questionable. On one hand, this will lead to a substantial monitoring effort for institutions, while it is not clear whether institutions will actually get the required information from their borrowers. On the other hand this could lead to the (potentially undesired) effect that in case the income of the customer decreases while he is still paying on his mortgage without delay, he may have to pay a higher interest because the part of the loan that benefits from the preferential treatment also decreases.

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? For both questions, any qualitative and/or quantitative evidence supporting your arguments would be greatly appreciated.

We think that no further preconditions are necessary.

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?

Yes, see answers above.

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?

One useful measure to dampen cyclicality would be to replace the market value by a „mortgage lending value“ which produces a property value that should be more stable over time. This would also make dispensable the proposal to link the loan-to-value ratios to the economic cycle.