European Banking Industry Committee

European Banking Federation (EBF) • European Savings and Retail Banking Group (ESBG) • European Association of Co-operative Banks (EACB)• European Mortgage Federation (EMF) • European Federation of Building Societies (EFBS) • European Federation of Finance House Associations (Eurofinas)/European Federation of Leasing Company Associations (Leaseurope)• European Association of Public Banks (EAPB)

Version 6 15 November 2017

EBIC considerations on the Risk Reduction Measures Package – Prudential parts

Translating the EU Single Market and the Banking Union into prudential realities

The single market for financial services, including the Single Rulebook for banking regulation, is a primary objective of the European Union. Thus, cross-border intragroup transactions should be treated equally as those within the same Member State to avoid any trapped pools of capital and liquidity. In the case of the euro area not only is there a Single Rulebook but also a common currency, a Single Supervisory Mechanism and a Single Resolution Mechanism. Thus, EU legislators should be more ambitious in recognising the single market for financial services in terms of applying the prudential capital and liquidity requirements at the consolidated level where appropriate, i.e. for banks with a centralised structure. In practice this should mean the following:

- Make waivers at solo level automatic and not discretionary: For LCR and NSFR purposes, liquidity subgroup status should be automatically granted for subsidiaries within the same Member State or different Member States. The double requirement both at solo and consolidated level does not reflect the way liquidity is managed in a centralised banking group. All the more within the Eurozone as there are no restrictions on the movement of capital and payments. In addition, we suggest that this should also apply for non-liquidity related parts of the CRR, such as own funds, capital requirements, large exposures, transferred credit risk, leverage and disclosure.
- Remove internal MREL: Internal MREL should not need to exist within the EU, and absolutely not within the Banking Union.
- Grant preferential treatment for intragroup transactions: The preferential treatment for intragroup transactions should be granted automatically and not subject to supervisory discretion.

Proportionality

Introducing more proportionate rules in the revised texts of the CRR and CRD IV is of high importance to EBIC. We are convinced that provisions on, *inter alia*, remuneration policies and reporting requirements should include more proportionality. In this respect, we advise not to look only at the size of an institution, but to take into account other factors as well, such as an institution's business model and risk profile.

In particular, the extent of the reporting requirements should be reduced by all means. Only as an example, at least the following reporting requirements have only a minor benefit for the competent supervisory authority in particular when assessing smaller institutions and should be removed:

- Reporting of asset encumbrance (Art. 100 CRR);
- Reporting of funding plans (EBA-Guidelines);
- Reporting of intraday liquidity (EBA-Guidelines);
- Reporting of additional liquidity monitoring metrics (ALLM, Art 415 (3) CRR).

In addition, the disclosure requirements laid down in Article 430a et seq. CRR II are far too detailed and require high implementation efforts. These efforts are in no way commensurate with benefit, also in terms of appreciation of information by the market, especially with regard to small institutions which are not active on the capital market and have no impact on the financial stability.

Financial Holding Companies

Extending the circle of directly supervised companies/institutions/entities to financial holding companies and mixed financial holding companies is critical. Such an extension of the scope of the CRR and CRD regulations is neither necessary nor appropriate. The subsidiaries of relevant holdings, which in turn as a group are already subject to regulatory requirements are already adequately monitored as such by the competent supervisory authorities. An extension of the circle of parent institutions subject to the direct supervision to those whose business consists almost exclusively of holding (investments in) participations and that conduct no significant business of their own or hold risk-relevant positions would, apart from considerable costs for the undertakings concerned, add no regulatory relevant value compared with the status quo.

These requirements would mean a massive shift of responsibilities from a CRR institution right up to the parent financial holding company. As a consequence of this significant change in regulation, the parent financial holding company would in the future be responsible for, among others, the areas: establishment of appropriate procedural-organizational arrangements at group level and setting up appropriate internal risk management and control processes. The resulting changes within financial holding groups are inadequate particularly for such structures where a parent financial holding company has only a direct holding in a downstream CRR institution as a participation/investment.

Should this over-regulation be pursued nevertheless, there is at least the need for permanent grandfathering arrangements for existing holding company structures, so that the fiction of authorisation is incorporated in the regulations. For the application of the new regulatory requirements, furthermore, the undertakings concerned must be given a reasonable transitional period of at least five years.

Own funds requirements

Since Basel II at the latest, extensive supervisory rules and regulations have already applied to investment funds. New rules inevitably lead to adjustment requirements and hence to new compliance efforts for all parties concerned – without necessarily showing a significant added prudential value. For this reason, we ask that the envisaged requirement for a new technical regulation standard be waived.
The intention of Article 52(1)(a) CRR II and Article 63(a) CRR II: in the future only such instruments that have been issued directly by the institutions can be considered as eligible capital. This requirement goes beyond the Basel requirements. As far as the background for this involves an intended alignment with the newly planned Art. 72a CRR II, it is not necessary to limit the scope of Article 52(1)(a) CRR II and Article 63(a) CRR II. The alignment in wording can be achieved equally well by a corresponding amendment to Article 72a CRR II. An appropriate amendment to Article 494a CRR would be necessary at the very least, in EBIC's view.
Apart from that, we would like to point out that, in 2016, the European market for cocos (AT1) shrank by a third. Analysts suggest that this is due to uncertainty about the risks of missed coupon payments on AT1 caused in part by the complexities of the link between AT1 and Available

Distributable Items (ADI). These uncertainties may be eliminated by deleting the link to ADI. It is therefore appropriate to remove the requirement that AT1 coupons be paid from "distributable items" (but not necessary to remove it for CET1 dividends, because CET1 is treated in a more or less harmonised way across the EU).
The newly introduced requirement in Article 52(1)(a) and (r) CRR II that offset possibilities should be excluded is, in our assessment, not required and should be deleted. Any possible amendment of the eligibility criteria in favour of a synchronisation with the BRRD concerns only the question of the write-down and conversion mechanism. Should this requirement be maintained anyway, comprehensive grandfathering arrangements would be necessary, in EBIC's opinion. According to existing CRR provisions, it was until now not required to exclude netting/setoff possibilities. Hence new issues made since 2014 probably do not all contain this clause. Without a transitional arrangement, once the proposed changes come into force, these issues would no longer be eligible as own funds. Such a far-reaching consequence does not seem to be appropriate, especially as the instruments have already been issued on the basis of the CRR and the institutions did not have to assume another change in the eligibility requirements. Instruments issued before the entry into force of the CRR changes, that meet the previous requirements, should therefore be fully eligible as capital until final maturity. EBIC considers a phasing-out period for previous instruments that were issued before the introduction of the CRR inappropriate. The gradual, step-by-step counting of instruments as eligible on the basis of regulations that, as in the old banking directive, were recognised as inadequate was appropriate. The CRR was not considered inadequate, however. Instruments issued on the basis of its requirements must therefore continue to be fully eligible.
Article 63(d) CRR II requires not only that claims on capital instruments of Tier 2 capital must be subordinated to the claims of all unsubordinated creditors, but rather that these claims on capital must rank "below any claim from eligible liabilities instruments", according to the provisions governing the instruments/subordinated loans. It is suggested here to concretise the term "applicable rules" by use of the wording that will in the future be used in the new Article 63(n) CRR II, namely "according to the law or contractual provisions governing the instruments". Otherwise – particularly in direct comparison with the wording of Article 63(n) CRR II – it would remain unclear, of what type these "applicable regulations/contractual provisions" must be. If this meant (only) contractual provisions, this pre-requisite of "subordination within subordination" in the regulations of Tier 2 instruments already in circulation would not be reflected (since hitherto not required by the CRR) and would again need a generous transitional provision.

<u>Distinction banking book – trading book</u>

Under the minimum capital adequacy requirements for market risks, provision is made for a new distinction between banking book and trading book. For many current non-trading book institutions, it is essential that, based on the new distinction, they should not be subject to the rules applicable for trading-book institutions. In this context, the organisation for the necessary approval for allocation of certain investments to the banking book in Article 104f CRR II should be easily practicable, in EBIC's view.
The CRR II provides for a derogation for small trading book business. The maximum volume of trading book business to qualify for the derogation is to be increased and established at EUR 50 million and 5 per cent of the total balance sheet. In view of the possibility also to be able to exempt institutions with small trading book business permanently, the limit of EUR 50 million should be raised significantly. The relative threshold should also be raised too, in EBIC's view.

Market Risk

Many key components of the FRTB are still being discussed at international level. The BCBS has recognised flaws in the calibration and is currently looking at adjusting them with an updated version expected by the end of 2017. The FRTB framework will have far-reaching consequences for banks and corporates. In addition, the uncertainty about the course of action in relevant jurisdictions such as the US raises level-playing field concerns that should be monitored. Consequently, we recommend that the Commission's FRTB package is put on hold until technical discussions are finalised and an updated text is available. Europe should not suffer from uneven playing field situations by frontloading international standards that are not yet finalised nor committed by other relevant jurisdictions.

Counterparty Credit Risk

The proposed simplified standardised approach for counterparty credit risk leads to considerably greater complexity. This is the reason why EBIC proposes allowing institutions with a low risk exposure to the derivatives positions in question to continue to use both existing methods, i.e. the Mark-to-Market Method and the Original Exposure Method.
Furthermore, EBIC believes it would be useful to apply for SA-CCR a transitional 65% scaling factor and 3-year monitoring period (similar to the FRTB) in view of an expected significant capital increase and considering the international state of art of the SA-CCR.

Appropriate calculation of the risk-weighted exposure value of funds

In our opinion, the risk-weighted exposure value of a fund share or unit in the standardised approach should continue to be determined by multiplying the average risk weight by the book value of the positions held by the institution and a derogation from the exposure value pursuant to Article 111(1) CRR (accounting value) should not be permitted. With unchanged market values of the positions held by the fund, this method leads to the same results as the method proposed by the EU Commission and Basel Committee. When market values of the underlying positions increase, institutions that recognise these exposures at amortised cost, set up hidden reserves to the same amount. These reserves fully cover any additional losses from increased market values, so that it is not necessary to cover these losses with own funds.
For funds to which neither the transparency approach nor the average risk weight approach can be applied, Article 132(2) CRR II assigns a risk weight of 1,250%. We believe this risk weight to be unjustifiably high. Currently, the risk weight applied to these funds in the standardised approach for credit risk is 100% and in the IRBA 370%. These weightings should continue to apply, in EBIC's opinion.
When one of the approaches referred to in Article 132a CRR II is applied, Article 132(3)(c)(iii) CRR II calls for an examination by a third party. For reasons of practicability and cost, it should be made clear that an annual review is sufficient in this regard.
The calculation of risk-weighted exposure amounts of the position held by the fund then leads to problems, particularly when it is performed by a third party (Article 132(4) CRR II). The fact is that in calculating the risk weighted exposure amounts of positions held by the fund, the fund company would not be in a position to use the accounting value. It would have to use instead the market values of the fund position. This would, on the one hand, mean that when calculating the risk-weighted exposure values of the positions held by the fund, there would be a derogation from the principle of applying the accounting value in the standardised approach for credit risk as the

exposure value. On the other hand, any gains in value in the assets held by the fund made after the purchase of shares in a fund would have to be covered by own funds. This is - as explained above - not justified in EBIC's view, as the accumulated hidden reserves fully cover any additional losses from the increased market values.
Furthermore, the multiplication by a factor of 1.2 proposed by the Basel Committee and provided for in Article 132(4) CRR II is, in our opinion, not justified. First, the risk of the fund position held does not increase by the fact that the risk-weighted exposure values (or, as in our proposal, the average risk weight of the fund) are calculated by a third party. Second, banks that have the risk-weighted exposure values (or the average risk weight) calculated by the investment company can regularly obtain from the investment company updated statements of the fund's asset positions, which enable the bank to verify the calculation of the investment company. Therefore, the bank concerned has the same measure of transparency as if it had, on the basis of information on the underlying transactions reported by the fund, itself determined the risk-weighted exposure amounts of positions held by the fund (or the average risk weight of the fund). Overall, there is therefore no additional risk that would justify an increase in capital requirements by 20%. Article 132(4) Sentence 2 CRR II should therefore be deleted. Only in the event that an average risk weight is used without transparency data, can one assume the use of the surcharge factor of 20%. EBIC would like to ask for a more accurate description of the facts in the legislative text.

Leverage Ratio

As has already been acknowledged by the EBA (in its report on the Leverage Ratio) and consequently the Commission, a 3% leverage ratio requirement would constrain certain business models and lines of business more than others. Therefore, adjustments of the BCBS' standard are warranted in order to avoid unintended negative consequences for the European banking sector.
EBIC members would therefore like to express their explicit support for the Commission proposal which enables a reduction of the leverage ratio exposure measure for public lending by public development banks (Article 429a(1)(d)), pass-through loans (Article 429(1)(e)), officially guaranteed export credits (Article 429a(1)(f)), and the initial margin received from clients for derivatives cleared through QCCPs (Article 429c(4)).
Lastly, we think it is important to ensure that a leverage ratio is not required at solo or sub-consolidated level.

Software investments

Banks contribute to the digitalisation of the EU economy and software has become a core asset for the banks business models around the world. Banks need to invest in software development to remain competitive and to strengthen their cybersecurity. However, software investments remain penalised in Europe compared to the US where software is risk weighted as an ordinary asset, like premises and equipment. The fact that every euro that an EU bank invests in an IT development needs to be backed with one euro of the most expensive category of funding is perceived as a significant disincentive for investments in innovation and a major factor of unfair competition. Fintech companies are not only a major competitor but also partners for the European banking sector. However, when a bank acquires a Fintech, its main asset (the software), is automatically depreciated given the deductibility that has to be applied to calculate capital levels for banks. If the buyer would be a non-bank, the deductibility would not take effect. This is like assigning a zero value to the search engine of Google if this were bought by a bank. Because of this, banks may be less open to financing these companies.

In EBIC's view, it would be disproportionate to put European banks at a competitive disadvantage to their US peers and new players in the market, such as Fintechs. Hence, we suggest that software, being an intangible asset, should not be deducted from CET 1. These exceptions should be introduced in Article 36(1)(b) CRR, in EBIC's view. Artificial hurdles to EU banks investing in digital should be removed, creating value for the economy as a whole and leading worldwide innovation in the area. Evidence clearly indicates that software has value even in the case of the liquidation of a bank.

SME Supporting Factor

EBIC very much welcomes the maintenance and extension of the SME Supporting Factor in the CRR II. In this respect, to increase clarity, we would welcome a sentence under the SME Supporting Factor stating that it is applicable to both types of banks, those using the standardised approach and those using internal models.
Furthermore, to ensure operational implementation, it could be considered introducing a simplified definition which does not rely on turnover information.

Infrastructure Investments

EBIC welcomes the Commission proposal to introduce lower own fund requirements for certain qualified infrastructure projects. From our point of view, this treatment is prudentially justified as available data shows that average recovery rates of such projects are significantly higher than those of non-qualified projects. Furthermore, EBIC members believe that the proposed requirements for the preferential treatment are appropriate. Nevertheless, some of them (e.g. Article 501a(1)(e),(f) and (g)(i),(ii),(v),(vi)) are not entirely clear and could be further explained.

Large Exposures

Regarding the calculation of the large exposures limit (Article 395(1) CRR II), the proposed restriction to Tier 1 in the CRR II draft is too restrictive, in our view, especially bearing in mind the tightening of the capital base with the CRR itself and further tightening of the large exposure rules, probably resulting from the proposed EBA Guidelines on connected clients. We would appreciate if Tier 2 could continue to be used to a certain extent as it is the case now (e.g. up to one third of Tier 1 capital). With a view on the proposed EBA Guidelines, we suggest clarifying the definition of 'groups of connected clients' in Article 4(1)(39) CRR to better reflect the current understanding based on the CEBS Guidelines from 2009 and the Basel Framework on Large Exposures from 2014 in the level 1 text of how severe and lasting funding or repayment difficulties must be in order to group two or more clients because of economic dependency ('substantial and existence-threatening funding or repayment difficulties'). The new EBA mandate according to Article 4(4) CRR II should be limited to large exposures.
Generally, taking into account proportionality and the ECB's AnaCredit project, EBIC believes that it would be a more appropriate approach to include only exposures that meet the large exposure definition according to Article 392 CRR in the reporting requirements: that is, those for which idiosyncratic concentration risk is limited through the large exposure rules. Reporting requirements that go beyond, such as the reporting of the ten largest exposures of institutions or 'shadow banking entities' – if at all – focus on sectoral concentration risk which is not covered by the current large exposure regime. What's more, setting an absolute threshold amount of EUR 300 million seems arbitrary to us. These additional reporting requirements represent a significant, disproportionate

burden which should be removed from the CRR II, in EBIC's view. We believe that the supervisory benefits do not justify the costs for the initial IT implementation and on an ongoing basis. Therefore, we recommend deleting in Article 394 CRR II the current requirements to report (i) the twenty largest exposures, (ii) the ten largest exposures to institutions, (iii) the ten largest exposures to unregulated financial sector entities (or as proposed with the CRR II shadow banking entities) and (iv) exposures of a value larger or equal to EUR 300 million (currently a requirement to be fulfilled only on a consolidated basis according to Articles 9 to 11 of EU-Regulation 680/2014 on supervisory reporting, which is proposed to be included in the CRR II as a new subparagraph to the first paragraph of Article 394 CRR II and extended due to the lack of the addition 'on a consolidated basis'.

Together with the deletion of the reporting requirement of shadow banking entities, proposed Article 395(5) CRR II should be deleted as well. Together with the deletion of Article 394(1)(3) CRR II, Articles 9 and 11 of EU-Regulation 680/2014 should be amended accordingly, that is in Articles 9 and 11(1) the references to Annex VIII and Annex IX should be deleted and in Articles 9 and 11(2)(g) should be deleted.

We are aware of the supervisory reasoning that if a credit risk mitigation technique (CRMT) has been used to reduce risk-weighted assets, it seems to be reasonable to use it for large exposure purposes as well, as proposed with Article 399(1) CRR II. However, the large exposure regime is a prudential regime of its own focused on capturing the idiosyncratic risk of each individual exposure, while the RWA calculation is by its nature more standardised as reflected by the exposure classification into classes. EBIC therefore believes that with respect to the use of CRMT the current approach should be kept and the proposed first sentence to Article 399(1) CRR II should be deleted.

Besides, mandatory substitution of the collateral provider as suggested with the CRR II when using the 'comprehensive method for financial securities' (Article 400(4) CRR II), would generally pose considerable challenges to banks' internal processes. Furthermore, the current drafting of Article 403 CRR II could be understood in a way that mandatory substitution always needs to be applied whenever a CRMT is used for large exposures, independent of using it or solvency purposes. Taking into account the collateral provider or issuers of financial securities in the large exposures regime causes a high level of procedural expenditures for monitoring large exposure limits, credit decisions and reporting. We do not believe that these expenditures are proportionate to the benefits of the rules.

Furthermore, the effects for certain repo and securities financing transactions (SFTs) might indeed be burdensome. Before each trade, institutions would have to negotiate with the counterparty about potential collateral providers and comply with internal limits. It would no longer be possible to execute triparty repo transactions through platforms such as EurexRepo since institutions would have no prior knowledge of the collateral pool and would not be able to influence its composition. From our understanding, the Basel Committee announced in paragraph 34 of its Framework on Large Exposures that it will review the comprehensive approach for SFTs. The yet-to-develop approach should then be applicable for large exposures as well. The Committee's expectation was that the review of the standardised approaches would have been completed in advance of the implementation deadline for the large exposures framework. Additionally, the Basel Committee clearly stated that in the event of a delay banks would be allowed to use the method they currently use for calculating their risk-based capital requirements against SFTs. We suggest that the European legislator should not go beyond Basel and therefore – if the general linkage for CRMT between solvency and Large Exposures is kept (Article 399(1) CRR II) – exempt SFTs from the mandatory substitution as long as the new comprehensive approach has not been finalised.

Interest rate risk in the banking book (IRRBB)

We appreciate that the proposal maintains the possibility for institutions to implement internal systems for the management of IRRBB. However, EBIC would like to point out the following with regard to the specification of a fall-back standardised methodology: It is of the utmost importance that there are no automatisms between the determination of the interest rate risk profile and a capital add-on. Two aspects are essential and need to be appropriately reflected: i) a breach of the outlier test should not automatically lead to capital requirements but it should only be a warning that triggers a discussion with the supervisor; ii) there should be no further standardisation of the treatment of IRRBB, a Pillar 2 requirement must remain institution specific and determined through supervisory discretion.
In addition, there should be no additional outlier test. Two outlier tests would send out contradictory signals, increasing complexity and creating confusion. The proposal to consider additional NII SOT should be removed.
Furthermore, in our opinion, the mandates for level 2 measures are too wide and open the way for undue normalisation of the risk charge that would not appropriately appreciate the risk of different institutions. We believe the mandate of EBA should therefore be restricted.

Prudential impact of the new IFRS16 standard on bank lessees

The new IFRS 16 standard on lease accounting, which introduces a new 'Right of Use' asset, would have a significant impact on the prudential ratios of credit institutions renting property and equipment as follows:
- Capital ratio would be impacted as the Right of Use would be an asset with a 100% risk weight;
- Leverage ratio would be impacted due to an increase in the total balance sheet;
- Net stable funding ratio (NSFR) would be impacted due to an increase in the required stable funding.

EBIC therefore recommends policy-makers to consider in the context of the CRR revision the negative effects of the new IFRS 16 standard on prudential requirements.

Net Stable Funding Ratio (NSFR) and market liquidity

The Commission proposal for the NSFR should be reviewed in order to support market liquidity and market making. The FRTB requirements, combined with the NSFR and leverage ratio, will have negative implications on banks' market making activities such as securities financing transactions and derivatives. The application of the NSFR rules would be detrimental for the functioning of the European repos and derivatives markets, and ultimately, for the European end users such as SMEs, larger corporates, pension funds and other client serving entities who seek financing and hedge away financial risk such as foreign exchange – and interest rate risk. Therefore, with regard to the NSFR, EBIC members recommend to carefully calibrate factors for repos and reverse repos as well as derivatives:
- **The asymmetric treatment of repos and reverse repos**: The Basel NSFR, even with the European Commission's proposed adjustments, is detrimental to the objective of the Capital Markets Union (CMU) as the NSFR overly penalises capital market activities. Notably, the asymmetrical treatment of repos (0% ASF) and reverse repos (5-10% RSF) risks reducing market liquidity and disincentives banks to provide liquidity to the financial market. Ensuring market liquidity while being consistent with the development of the CMU, EBIC members recommend

that reverse repo are treated the same as repos when they are executed with regulated financial institutions.

- **Margined derivatives**: In our view, the additional 20% RSF on gross derivative liabilities should be complemented with other options as it is an extremely approximate measure; it could overestimate funding risk and have negative consequences on activities of relevance to support financing of the real economy. While we support the intention of the Commission to introduce a more risk-sensitive approach than the 20% RSF, the Commission proposal is not only not risk sensitive but it would require significant additional funding for no reason, which would translate into an additional annual cost of funding. It would have relevant negative consequences for both financial institutions and end-users, such as corporates. In this regard, the Commission proposal should reflect the latest BCBS agreement that, at national discretion, jurisdictions may lower the value of this factor, with a floor of 5%.
- **Unmargined derivatives**: The Commission's 10% RSF add-on for a future potential derivative exposure using gross derivative liabilities remains an inadequate and highly inaccurate measure of the potential change in the funding requirements generated by the derivative portfolios. EBIC proposes that this requirement is removed entirely. As a second best option, should an alternative be considered, we suggest that, to be consistent with the intent described in recitals, the 10% RSF should apply only to non-margined derivatives that are subject to contractual clauses which could lead to collateral to be posted. Furthermore, we note the current ongoing review at Basel level of the metric, through the recently launched QIS exercise to address the shortcomings of the proposed BCBS methodology. Thus, the EU should carefully consider future changes and consider putting forward its own view on the optimal solution for unmargined derivatives.

NSFR, covered bonds and their cover assets

Covered bonds, with their unique legal and supervisory framework, structural, transparency and safety features represent the most stable, and available, funding tool for EU based financial institutions. European banks use them to channel long-term private funding into the real economy in a stable and countercyclical way.

The NSFR framework is, in our view, a key instrument to avoid excessive maturity transformation and to preserve financial stability. This said, the current calibration of the NSFR for covered bonds and their cover assets appears to be too restrictive especially considering the nature of covered bonds as long-standing successful long-term funding instruments. In our view, without adaptions a large part of the European mortgage market will have to be funded differently (compared to the current situation). This is why a "deviation" from the Basel standard could be justified in the following way:

In our view, in order to maintain the incentive to reduce maturity transformation and, at the same time, preserve, to the extent possible, a level playing field between funding sources, we propose to reduce the discrimination between assets inside and outside the cover pool by lowering the RSF for encumbered assets in the cover pool to 85%.

Additionally, EBIC would also put forward the idea that Article 411 CRR II should be amended as the definition of the non-mandatory overcollateralisation is not entirely in line with the functioning of the covered bond structure. The minimum overcollateralisation imposed by rating agencies should be taken into account to the extent that not meeting such requirements could materially impact the bank's targeted rating of the covered bonds, thus impairing the future ability of the institution to issue new covered bonds. It is also our view that the proposal to define level 1 and 2 assets in a cover pool as encumbered assets, as in Article 428p CRR II, is in conflict with the purpose of such assets, since these assets constitute a liquidity risk mitigation tool related to the covered bond issuance

Pillar 2

In general, EBIC very much supports the streamlining and additional clarity provided in the proposal where the Pillar 2 requirement is split into a hard Pillar 2 capital requirement (P2R) and a soft Pillar 2 capital guidance (P2G) whose breach does not automatically result in pay-out restrictions. This was necessary to allow institutions to better understand and plan capital needs also on the basis of the supervisory dialogue. We believe that a further reference could be introduced to include in the scope of exclusion from additional own funds also certain other risks that are sufficiently covered under Pillar 1.

We would advise against a mandate for the EBA to develop RTS specifying how risk and elements of risks that are not covered or not sufficiently covered by Pillar 1 shall be measured. The use of an RTS presents an excessive risk of standardisation and mechanisation of Pillar 2 requirements, which should by their very nature remain institution specific and risk sensitive. This is even more relevant in the context of the supervisory practices and expectations being developed, where institutions are required to develop - in the context of the SREP - their own risk taxonomies and inventories.

Moreover, in EBIC's opinion, it should be clarified that the P2G can be offset against the capital conservation buffer. The rationale for this is that the guidance and the capital conservation buffer have the same objective: a buffer for losses to maintain capital adequacy in times of stress. Expecting institutions to hold double the amount of capital for the same objective would be inappropriate.

Finally, EBIC believes that Pillar 2 should be a pure micro-prudential tool (potential capital add-ons have to be linked to individual risks) focusing on the safety and soundness of individual institutions. We do not appreciate if supervisors use their Pillar 2 tools also for macro-prudential purposes. To address systemic risk, several specific macro-prudential tools are available and, in our view, are better suited. Therefore, the possibility to address systemic risks through Pillar 2 should be removed from CRD V. The reference in Article 104a(1) CRD V goes in the right direction and is appreciated by EBIC.

Eligible liabilities and grandfathering

Some of the newly proposed requirements for eligible liabilities go beyond the requirements in the TLAC term sheet and appear not to be aligned with the objectives of TLAC/MREL, and as such unnecessarily restrict European banks. In particular, this concerns the additional criteria that have been introduced in Article 72b(2)(k),(m) and (o) CRR II including authority approval for redemption, acceleration clauses as well as contractual bail-in provisions. Against this background, the possibility to delete these criteria should be explored.

Apart from that, EBIC members are concerned that it will be impossible to meet the new MREL requirements in the short term without being able to include current outstanding senior unsecured debt. Therefore, a comprehensive reporting-date-related grandfathering clause on existing business is required that ensures that until the entry into force of the CRR II, issued instruments are assessed solely by the hitherto existing criteria and thus continue to be eligible until their maturity.

Maximum Distributable Amount (MDA)

The proposal indicates that any breach of the MREL for longer than 6 months triggers distributions' restrictions (MDA). This provision should be removed and left as an option for the supervisory authorities or joint supervisory and resolution authorities. This link between capital requirements addressing a going concern situation (CRR/CRD IV) and the gone concern framework should be avoided as it would create important practical difficulties. We believe that MDA restrictions should not be automatically triggered by a breach of the combined buffer which occurs only due to insufficient MREL. EBIC is in favour of disconnecting MDA from MREL and it should also be noted, for instance, that this approach has been adopted by the Bank of England.

A triggering of the MDA in one entity of a group should not produce an automatic spill over to all of that group's entities, but primarily reside with the responsible entity. The calculation of the MDA at consolidated level would not reflect the capital situation in certain banking groups and networks. Indeed, if at a consolidated level there might be a breach of requirements due to the capital position of a specific institution of the group, this would reflect in a contagion of distribution restrictions also for the other institutions which are instead sound and able to meet their obligations.