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EBF COMMENTS ON THE ECB PUBLIC CONSULTATION ON THE EXERCISE OF OPTIONS AND DISCRETIONS (PART 2)

GENERAL COMMENTS

1. It is generally accepted that ppublic and stakeholder consultation is integral to well-informed decision-making and to improving the quality of law making. An effective and structured consultation process which includes a genuine invitation for comments from stakeholders is a crucial component of and contributor to a transparent regulatory system.

   One key aspect of a proper consultation process is the importance of allocating sufficient time for stakeholders to respond so that stakeholders have the ability to adequately evaluate the full consequences of the proposed regulations. The present Consultation was launched on 18 May 2016, specifying that it runs until 21 June. This means that the consultation period is about one month. The Consultation paper does not make any mention of reasons which would require the consultation period to be restricted to such a short timeframe.

   In a paper which the ECB published in 2009, it was highlighted that experience of the ECB has shown that it needs between six and eight weeks to finalise an opinion[1] "*to take into account and reach a consensus between the views of all governors before adopting an opinion*"[2]. Similar considerations apply where banking associations are concerned which are expected to adopt a pan-European view and, as a result, also need to be allocated sufficient to reach a consensus amongst their membership. We would like to highlight that a range of comments made by our members which seemed valuable could not be considered because time had been lacking to take them through due process.

   We conclude that due process requirements have not been met. We expect the ECB to meet higher consultation standards in the future

2. The "Explanatory Memorandum on the Addendum to the ECB Guide on options and discretions available in Union law" highlights that National Options and Discretions need to be lifted, amongst others, to establish a level playing field and to reduce operational complexity. We fully concur with this view.

[1] "The legal duty to consult the European Central Bank", Legal Working Paper Series n° 9/November 2009, p. 32.
[2] Ibidem, p. 33.

We note, however, that this approach is not consistent with the AnaCredit Regulation which the European Central Bank has issued and which aims at collecting granular credit and credit risk data which will also be used for banking supervision purposes within the SSM framework. The AnaCredit Regulation does not only keep existing national options and discretions in the area of statistical reporting untouched but has, moreover, introduced a range of new national options and discretions.

SPECIFIC COMMENTS

1) **Capital Waivers** (Article 7 CRR)

The legality of what is being proposed is highly questionable

We strongly challenge the view taken in the draft Addendum that Article 7(1) of the CRR would allow the supervisor to make the granting of the solo capital waiver subject to an assessment of the leverage ratio.

- Because the CRR level 1 text is very precise about the various conditions which need to be fulfilled to grant a waiver, one needs to conclude that the list of conditions which it puts forward is meant to be exhaustive.

  Leverage is neither directly nor indirectly mentioned in these conditions. If the intention of the legislator would have been to authorise the supervisor to consider the leverage when granting a capital waiver, the text of Article 7 would have specified so. The ECB simply needs to abide by Level 1 legislation and cannot impose a further condition which is not covered by Article 7(1). It cannot make use of recitals preceding the CRR text either as an excuse to re-write legislation.

- Submitting the granting of a capital waiver to the assessment of the leverage ratio requirement by the ECB would only affect banks of the Banking Union and for the moment only the ones which are under its direct supervision. As a consequence, the ECB would ignore single rulebook requirements and introduce substantial competitive distortions.

Assessment process is not clear

The draft Addendum explains that, "*in assessing an application for a capital waiver, the ECB will ensure that considerations related to the leverage ratio are taken into account*". It adds that "*in particular, the ECB will consider the factors set out under paragraph 4 of this Chapter*".

The reference made to "paragraph 4 of this Chapter" is most unclear. More precision would be welcomed.

Legitimate expectations

Until November 2014 capital waivers were granted by national competent authorities without considering the leverage ratio. As Article 7(1) of the CRR has not been amended by the EU legislator in the meantime, banks should be able to trust that waivers which have been granted in the past, will be maintained.

As a consequence, it would be useful for the final text of the Memorandum to state in an unambiguous way that waivers which have been granted in the past in compliance with the CRR will be maintained.

2) **Exclusion of Intragroup exposures from the calculation of the Leverage ratio** (Article 429 (7) CRR)

- It would be useful for the final text to confirm for the sake of clarity that if an intra-group waiver has already been granted, it remains applicable going forward considering that, in the context of the Banking Union / SSM, setting waiver conditions conflicts with the core principle of free flow of capital and liquidity and, moreover, that legitimate expectations need to be observed

- Some of the criteria which need to be met to obtain this exclusion are not clear.

  - Sub-paragraph 1: The ECB will verify "the potential impact on the bank of a change in economic and market conditions" on the basis of "the assessment by the Joint Supervisory Team (JST) of the liquidity and funding risk of the credit institution in the context of the SREP".

    This statement begs the question to what extent the assessment made by the JST of the liquidity and funding risks in the context of the SREP will be binding to the ECB. This needs to be clarified to avoid arbitrariness. The assessment which the ECB indicates it will undertake seems to be aimed at addressing situations where the controlled entity might face funding problems and cannot use the liquidity posted with the holding company. In reality we presume that the entity could, also under a stressed scenario, close or reduce the intra-group funding if/when needed, whereas the holding group has, at Group level, contingency funding measures in place to deal with a crisis. Therefore, the issue does not seem to be so much at the individual entity level, but rather at Group level, if any.

  - Sub-paragraph 2: The ECB will verify the materiality of the intragroup exposures of the applying entity and intends to carry out a forward-looking assessment to ascertain that the exemption does not have the effect that leverage would no longer be adequately measured by the leverage ratio " (see under (2) at page 3).

    Making reference to a « forward looking assessment » is rather vague and unprecise. The ECB Guide should be more explicit on, what a "forward looking assessment" would entail to avoid arbitrariness.

  - Sub-paragraph 4*:* The CRR does not consider a leverage ratio as a condition for granting capital waivers and for applying a zero risk weight to intra-group exposures and the leverage ratio as prudential requirement will become applicable only as of 2018. As a consequence, until this date, the ECB is not authorised to add a leverage assessment.

- It needs to be observed, moreover, that, considering the interconnectedness which exists between the CRR and the BRRD, the additional guidance which the ECB proposes introducing concerning the possible effect of some CRR related requirements or assessments on the recovery and resolution plan, may create legal uncertainty.

  If clarification is needed about how the capital waiver and a zero risk weight for intra-group exposures interact with a binding leverage ratio requirement as of 2018, it must be done by level 1 legislation.

3) Valuation: use of IFRS for prudential purposes (Article 24 (2) CRR)

a) General outlook

The Draft Addendum to the ECB Guide highlights that the ECB does not intend to exercise the option to require credit institutions to effect, for their prudential purposes, the valuation of assets and off balance-sheet items and the determination of own funds in accordance with International Accounting Standards. We have, however, understood from the explanations which ECB representatives provided at the public hearing that, with a view to promoting consistency and comparability, the ECB would be rather in favor of banks using IFRS and that it would as a consequence be flexible in considering requests for the use of IFRS. It was also emphasized at the public hearing that the level playing field between European institutions would benefit if many banking groups would opt for making use of IFRS. It is surprising against this backdrop that the various conditions which are being set in the Draft Addendum to obtain make use of the IFRS option are rather rigorous and difficult to be met.

b) "Banking Group"

The reference which is being made to the concept of "banking group" needs to be clarified. Does it only refer to banking groups as a whole or do sub-groups also qualify. To be more precise: does it cover all entities which are included in the consolidation scope of the "EU Parent institution"? Or does it refer to a sub-group composed of entities which are included in the consolidation scope of a "Parent Institution in a member State?"

c) Conditions set

We strongly disagree with the conditions which the ECB proposes to set with regard to its acceptance, on a voluntary basis, of the use of International Accounting Standards for prudential reporting.

- The second condition - according to which the application needs to have been submitted by all the legal entities within the banking group which will actually apply the IAS for prudential reporting - should be deleted as there is no justification for this condition. A legal entity should be allowed to make use of IAS even if its parent institution and/or other subsidiaries within the banking group would not apply for it.

  However, should this condition be maintained, it should be clarified that it targets only the SSM credit institutions belonging to a given "banking group", with the definition of “banking group” being clarified as proposed above, i.e. a sub-group composed of entities which are included in the consolidation scope of a “Parent Institution in a Member State.”.

- The third condition – according to which for prudential purposes the same accounting framework should apply to all reporting entities within a group – also needs to be deleted as it is not justified.

  The reason provided in the consultation paper – i.e. to ensure consistency between subsidiaries established in the same Member State or in different Member States – is not convincing considering that there is no such consistency today: different accounting frameworks for prudential purposes apply to different reporting entities within a cross-border group.

  We also oppose the proposed “all or nothing” approach because it seems out of line with the principle of proportionality if it would result in disallowing the use of IAS even if a minority of entities within the group is making use of a different accounting framework.

d) <u>Documentation requirements</u>

We note that institutions applying for the use of IAS for prudential reporting are expected to provide the ECB with a legal opinion demonstrating that there are no obstacles in their national legal framework to prudential reporting under IAS on a voluntary basis. This opinion should, moreover, be approved by the management bodies of the applying entities. We do not understand why a management body would need to be invited to “approve” a legal opinion. It should suffice for the management body to confirm that it has taken knowledge of the legal opinion.

Finally, we note that the last sentence clarifies that “the use of IFRS for prudential reporting requirements will apply permanently, after the notification, from the credit institution, to all relevant prudential reporting requirements, common reporting (COREP), financial reporting (FINREP); short-term exercise, etc.”. We should be grateful if the final text would be more specific on what could be meant by “etc.” at the end of the last sentence.

4) **Calculation of risk-weighted exposure amounts – Intragroup exposures** (Article 113 (6) CRR)

- It would be useful for the final text to confirm for the sake of clarity that if an intra-group waiver has already been granted, it remains applicable going forward considering that, in the context of the Banking Union / SSM, setting waiver conditions conflicts with the core principle of free flow of capital and liquidity.

- We note that institutions applying for the waiver are not only expected to provide the SSM with a cover letter signed by the legal representative of the parent undertaking (see under vi) and, moreover, with a legal opinion (see under vii). Those documents need, moreover, to be approved by the management body. Here again, we do not understand why a management body would need to be invited to “approve” a legal opinion. It should suffice for the management body to confirm that it has taken knowledge of the legal opinion.

- We believe that it should be possible to alleviate the administrative burden of the applying bank by simplifying the legal documentation requirements. Is it really necessary that the bank should obtain an opinion from two different legal experts? Is it really necessary to require banks to submit two separate legal documents?

  We note, moreover, that some of the requested documentation seems to overlap with documentation requirements which have been included in other regulations.
  (i) documentation required under 6, (i), (ii), (iii) and (iv): this information needs to be disclosed in the Risk Appetite Framwork (RAF) Policy. Therefore, a reference to the RAF Policy should be sufficient here;
  (ii) documentation required under 7 (v): such information should be covered by the bank recovery plan. Upon confirmation, the text should replace point (v) by a reference to the Recovery Plan.

5) Liquidity - Cap on Inflows (Article 33 (2) Delegated Regulation)

- It would be useful for the final text to confirm that the conditions set by the ECB for granting the exemption under Article 33 (2) only apply in respect of request which will be made after the entry into force of the draft addendum to the Guide and that, as a consequence, they will not be applied in a retro-active way to requests which are under instruction or impact exemptions which have been granted in the past.

- We do not share the view expressed in the Draft Addendum to the ECB Guide (at page 8) ”that under certain conditions the exercise of this specific option on liquidity requirements, when considered in combination with the option in Article 34 of ”” (…) “could, from the liquidity receiving entity’s perspective, produce a comparable effect to an Article 8 CRR waiver” (…).

  Under a waiver, the entity would only need to report its LCR and not be required to fully comply with the 100% requirement in 2018 whilst an entity benefiting from an exemption from the cap on intragroup inflows (based on Article 33(2)) only, would, in contrast, still need to comply with the 100% LCR requirement and would need, to this end, to obtain committed liquidity from its parent (either in a funded format if under Article 33(2) in isolation, or in an unfunded format if in combination with Article 34) for an amount consistent with its LCR outflows. This committed liquidity would symmetrically be accounted for as LCR outflows for the providing parent which would need to hold corresponding HQLA to comply with LCR. So while the Article 8 CRR waiver enables to enforce liquidity requirements at sub-consolidated level only, Article 33(2) exemptions would still require adequate liquidity to be pre-positioned at both providing and receiving entity.

  It should be reminded that CRR has introduced "superequivalence" (i.e. "goldplating") vs Basel LCR standards by requiring LCR compliance for all credit institutions at solo level. The exemptions under Article 33(2) and Article 34 were introduced in the CRR to allow specialised subsidiaries of European banking groups to comply with LCR while not imposing decentralised High Quality Liquid Assets (HQLA) buffer management at entities which may not have adequate operational set up or skillset. As a consequence, we consider it appropriate for the CRR to have set different, less stringent, specifications for the exemption under Article 33(2) than for Article 8 waivers and that ECB would only further 'goldplate' CRR requirements if it would apply similar requirements.

Furthermore, the practical consequences of the proposed approach are unclear:

- are institutions applying for an exemption under Article 33(2) required to provide the same documentation as for Article 8 waivers?
- will the ECB grant joint Article 33(2) and Article 34 exemptions only in situations where the applicants would be ineligible to an Article 8 waivers for reasons beyond their control?

<u>For all these reasons, we suggest deleting this provision</u>.

- Moreover, the Draft Addendum reports that "in cases where the conditions for the Article 8 CRR waiver cannot be met for reasons that are not under the control of the institution or the group, or where the ECB is not satisfied that an Article 8 CRR waiver may actually be granted, the JST will consider instead the possibility of granting a combination of the preferred treatment under Article 34 of Commission Delegated Regulation (EU) 2015/61 and the exemption to the cap inflows pursuant to Article 33(2)(a) of Commission Delegated Regulation (EU) 2015/61". (page 9)

  In order to provide institutions with a more complete view on liquidity issues, <u>it would seem more appropriate if the ECB would specify the conditions under which the combination of the options of Article 34 and Article 33 of Commission Delegated Regulation (EU) 2015/61 can produce a comparable effect to Article 8 CRR.</u> For the same reasons it would be important to understand the criteria, systemic and idiosyncratic, that could lead the JST to approve the combination of Articles 33 and 34 of Commission Delegated Regulation (EU) 2015/61 while the ECB did not allow the Art.8 CRR waiver.

- We would like to propose amending the conditions for Article 33(2) exemptions which are listed on page 10, under paragraph (2) which deals with situations in which the exemption is not requested in combination with Article 34 :

  - criterion (viii) should be amended as it basically requires the subsidiary which receives the funding to monitor the liquidity position of its parent company on a regular basis. Considering that the counterparty (i.e. the parent) itself needs to comply with LCR requirements (as per criterion (vii)) and that it is a supervised entity, sufficient assurance is in place that its liquidity position is adequate.

  - criterion (ix) requires the applicant institution be able to factor in the impact of granting the exemption on its risk management systems. We do not understand how the granting of the exemption may impact the risk management systems of the applicant institution. We would like the meaning of this requirement to be clarified.

6) Combining the functions of Chairman & CEO (Article 88 (1) CRD IV)

a) *<u>The separation of the executive and non-executive functions</u>*

The draft Addendum to the ECB Guide introduces this item in observing that "*the ECB considers that the separation of the executive and non-executive functions is the general rule for credit institutions.*" A close examination reveals that such a statement is not supported by the applicable legal framework:

- Article 88.1.e of CRD IV stipulates that: "*the chairman of the management body in its supervisory function of an institution must not exercise simultaneously the functions of a chief executive officer within the same institution, unless justified by the institution and authorised by competent authorities*."

  This provision is not saying that the chairman on an institution should not have executive powers. It merely prohibits one and the same person to exercise the functions of the Chairman and CEO (with the aim to avoiding the concentration of power in a single person).

  It needs to be highlighted that various Member States have implemented Article 88 CRD IV by means of legislation[3].

- The Guidelines of the Basel Committee on Banking Supervision setting the Corporate Governance principles for banks (July 2015) cannot be used either to support the general view taken in the draft Addendum. Paragraph 62 of those Guidelines acknowledge way that "*In jurisdictions where the chair is permitted to assume executive duties, the bank should have measures in place to mitigate any adverse impact on the bank's checks and balances, eg by designating a lead board member, a senior independent board member or a similar position and having a larger number of non-executives on the board.*"

  The Basel text is unambiguous: a chair is permitted to have executive duties. Moreover, the spirit and objective of the Basel guidelines are clearly not about prohibiting a chairman to assume executive duties but about preventing an excessive concentration of power in an executive chairman.

- Likewise, the European Banking Authority's Guidelines on Internal Governance (GL 44), stipulate (under point 14.5) that "*In a one tier system, the chair of the management body and the chief executive officer of an institution should not be the same person. Where the chair of the management body is also the chief executive officer of the institution, the institution should have measures in place to minimise the potential detriment on its checks and balances*".

These three documents (as well as all the working documents accompanying the preparation of the Directive, and more specifically the impact assessment dated 20/07/2011), convey the same message: it is best practice to split the roles of chairman and CEO, but this does not

[3] CRD IV has been implemented in Spain by means of Article 29 of "Law 10/2014 on the regulation, supervision and solvency of credit institutions" which requires all the members of the Board of Directors to meet a range of fit and proper requirements and which also imposes limits to the number of directorships held in other companies. These requirements are both applicable to executive and non-executive board member, and have been imposed considering it is the only way to guarantee the capacity of each director exercise their supervisory role within the Board.

mean that it is inappropriate to have an executive chairman. As a result, the starting point which the ECB proposes adopting - i.e. that there would be a need to separate the "executive and non-executive functions" - is not consistent with the current applicable legal framework. The final text of the Memorandum should, therefore, restrain from stating that" *the ECB considers that the separation of the executive and non-executive functions is the general rule for credit institutions.*"

Against this backdrop, we propose the following amendments to the text of point 9.3. the draft Addendum:

> ~~"*The ECB considers that the separation of the executive and non-executive functions is the rule for credit institutions*~~. *(if the elimination of this first sentence is not accepted, we propose the text to be substituted by the following one: "The ECB considers that the separation of the functions of Chairman and CEO is the rule for credit institutions).* ~~*Sound principles of corporate governance require that both functions be exercised in line with their responsibilities and accountability requirements.*~~
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> ~~*The responsibilities and accountability requirements of the chairman of the management body in its supervisory function (Chair) and the chief executive officer (CEO) diverge, reflecting the different purposes of each supervisory function and management function respectively.*~~
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> ~~*Moreover, the*~~ *The Corporate Governance principles for banks (Guidelines) of the Basel Committee on Banking Supervision (July 2015) recommend that in order "to promote checks and balances, the chair of the board should be an independent or non-executive board member. In jurisdictions where the chair is permitted to assume executive duties, the bank should have measures in place to mitigate any adverse impact on the bank's checks and balances, e.g. by designating a lead board member, a senior independent board member or a similar position and having a larger number of non-executives on the board." (Paragraph 62).*
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> *The authorisation to combine the* ~~*two*~~ *functions of the chairman of the management body in its supervisory function and of a chief executive officer* ~~*of*~~ *should, therefore, be granted only in exceptional cases and only where corrective measures are in place to ensure that the responsibilities and accountability obligations of both functions are not compromised by their being combined.*
>
> *The ECB intends to assess applications for the combination of the two functions in line with the above- mentioned Basel principles and the European Banking Authority's Guidelines on Internal Governance (GL 44), where it is recommended that* ~~*in the case of combination of the two functions,*~~ *"Where the chair of the management body is also the chief executive officer of the institution, the institution should have measures in place to minimise the potential detriment on its checks and balances*"