afme/ Finance for Europe

Association for Financial Markets in Europe

CRD IV

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Capital Transition

The Issue

Compared to Basel III, the CRD IV transitional arrangements allow member states to either accelerate or decelerate their flight path to the full capital requirements expected by 2019. AFME is proposing that the transitional arrangements in the CRD IV Regulation (CRR) be aligned with those in Basel III.

The proposed transitional arrangements will significantly decrease the comparability of capital levels across Europe and globally and will decrease transparency and market discipline. This is due to the transitional arrangements allowing multiple transition percentages for a number of different aspects of the capital calculation, to be decided upon at member state level. AFME is proposing a single percentage for each period and removal of the national discretion.

Transition of the Headline Rate

Article 448 relates to the transition to the new Basel III minimums for Common Equity Tier 1 (CET1), Tier 1, and Tier 2 (T2). The CRD IV transition for capital should be aligned with Basel III, with a single percentage for each period and no national discretion. Compared to Basel III, the CRD IV transitional arrangements allow member states to either accelerate or decelerate their flight path to the full capital requirements. There risk is that individual country acceleration is likely to be transmitted to other countries due to market and investor pressure, undermining the considered transition period allowed in Basel III.

Transition of Underlying Variables

The transitional phasing in Articles 449, 450, 458, 459, 460, 461, and 464 should be aligned with Basel III to ensure consistency and comparability of capital levels across Europe. These Articles refer to the transition to the full CRD IV requirements with discretion for member states to apply more rapid transitions. The Articles refer to:

- recognition of unrealised losses and gains (Articles 449 and 450)
- deductions from CET1 items, Additional Tier 1 items, and T2 items (Article 458)
- non-qualifying capital instruments issued by subsidiaries (Article 459)
- minority interests (Article 460)
- additional filters and deductions (Article 461)
- grandfathered instruments (Article 464)

AFME's concern is that different implementation velocities across Europe will undermine market transparency and therefore market discipline. For example, say under Article 464 Member State A requires full implementation on 1 January 2013 (i.e. 0% recognition) and Member State B requires graduated implementation in line with the steps in paragraph 5 (e.g. 90% recognition in 2013, 80% in 2014, and so on). This different treatment will make it difficult to compare the capital levels of banks from each member state. While banks from the two member states may have the same headline capital (say 10% CET1), the different

treatment of the transition period means that the headline comparisons are not fully illustrative of the institutions' capitalisation. Trying to catalogue and decipher the publications of applicable percentages by competent authorities and understanding how these translate to the true capital position for each institution will add an unnecessary level of opacity and complexity for the market. AFME proposes that text be amended to allow only a single percentage for each period and to remove the national discretion. This is in line with amendments contained in the December 2011 Karas Report.