European Banking Authority
Via email: EBA-CP-2012-10@eba.europa.eu

30 September 2012

RE: Response to EBA/CP/2012/10

Dear Sir or Madam,

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on the EBA's consultation paper on technical standards for the calculation of credit risk adjustments under Article 105(4) of the CRD IV Regulation (CRR) (EBA/CP/2012/10). AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME participates in a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) through the GFMA (Global Financial Markets Association). AFME is listed on the EU Register of Interest Representatives, registration number 65110063986-76.

During the CRD IV legislative process AFME has proposed amendments related to credit risk adjustments (please see Annex 1). AFME reiterates its view that these changes to the text of the CRR are appropriate and will align with both Basel and the current CRD approach. The amendments allow deduction of both specific and general credit risk adjustments from the exposure value under the standardised approach. This approach is appropriate as both specific and general credit risk adjustments are constituted though P&L accounts and are therefore already taken into account in CET1. Whereas this RTS maintains that both specific and general credit risk adjustment amounts are reduced from CET1, it also provides that the general credit risk adjustment should not be deducted from the exposure value which inevitably leads to double counting of general credit risk adjustment in the numerator and the denominator of the solvency ratio. The amendments propose reverting back to the current CRD approach. We suggest EBA support this.

In principle, the prudential definition and treatment of credit risk adjustments should be consistent with the accounting standards. As a matter of fact, the current IAS incurred loss model does not create any general credit risk adjustment according to the definition set out in this RTS while the upcoming IFRS will as it moves to an expected loss model. We believe that it would not be appropriate for changes to accounting standards to result in fluctuating regulatory capital. Therefore, we suggest EBA consider waiting for the finalisation of the accounting project, which is scheduled for 2013, and align its final RTS with the outcome. Alternatively, this RTS could be written in a neutral way so the prudential treatment of credit risk adjustments is not affected by changes to accounting standards.

Further, we note that other adjustments flow through the P&L and should properly also be included within this framework (e.g. fair value adjustments). However, a narrow definition of 'credit risk adjustments' mitigates against this, leaving a situation where the value of an asset is reduced but an institution still must hold capital against the non-reduced value. Although CRD IV refers only to 'credit risk adjustments' other valuation adjustments that go through the P&L could also be credit-motivated, as these will occur when an institution doubts the creditworthiness of the asset. We believe it is appropriate to take a wider view of 'adjustments' – not just those relating to 'credit risk' under the regulatory framework – properly aligning the regulatory and accounting treatments.

With regards to *Question 1* we believe that there will still be some lack of clarity about exactly which accounting rules are referenced by the provisions of the RTS. While we understand the need for a broadly worded RTS to account for different accounting standards and changes over time we believe this lack of clarity could be rectified by the EBA publishing a living 'guidance' document that maps particular provisions of the RTS to accounting rules. Such a document could be updated as needed, though noting our earlier comments questioning the appropriateness of changes to accounting standards leading to fluctuating regulatory capital.

One aspect of the RTS that could be clarified is the treatment of securitisation positions where a bank is an originator as the RWA treatment of securitisations diverges considerably from accounting standards. The accounting rules usually act as if there is no securitisation. This means that the underlying assets stay on the balance sheet, but the 'retained positions' in the securitisation positions (the notes) are not reported on the balance sheet. This has the knock-on effect that the notes do not have accounting based valuation adjustments against them, because they do not exist to be adjusted.

However, value adjustments may have been made on the underlying assets, and hence impact the capital of the bank. The wording in the legislation in Article 261 only allows credit risk adjustments in underlying adjustments to be held against the deductable pieces only even though the higher rated pieces are also written down. The higher pieces can only be written down according to valuation adjustments on the positions (rather than the underlying assets).

Prior to the EBA guidance, a bank may have made a risk-based assessment that would allow the effective capital hit on the underlying assets to be represented at the position level, hence accurately reflecting the true risk of the securitisation positions. Again, this comes in part from the fact that the RWA treatment of securitisations diverges considerably from accounting standards. However, because the draft RTS requires alignment with the accounting standards this prevents such a risk-based approach, meaning that originating institutions would see a P&L hit but also have to hold capital against them.

With regards to *Question 2* we note the asymmetrical treatment related to timing, and the potential delay recognising beneficial adjustments. The draft RTS is clear in Article 2(1) that adjustments cannot be made until CET1 has been charged. Current year adjustments, in current year P&L, will only impact CET1 when the P&L is audited (noting that current year losses (and adjustments) will be immediately recognised in CET1, so the issue does not arise). This treatment is detrimental to the capital position of an institution. For symmetrical treatment an additional category of CET1 is required for unaudited provisions/adjustments.

With regards to *Question 3* we support Option 2 as set out in the impact assessment of the consultation: that the decision about how to assign portions of the amount resulting from specific credit risk adjustments (SCRAs) to the exposures in a group should be left to an institution. We do not believe that allowing this option will be detrimental to the single rule book and request further analysis from the EBA to make the case that a single approach is necessary. Both approaches are currently used across the industry. Requiring a single approach would entail system changes among a subset of institutions and so a single approach should only be pursued if the EBA can demonstrate that it is required.

We note also that the preferred approach of the EBA could have an affect on an institution's large exposures positions. Apportioning SCRAs on the basis of RWAs (per Article 3) rather than on the basis of EAD could lead to an outcome where a high value RWA in a group of exposures takes the greater part of the group SCRA leaving other exposures with little or no adjustment to EAD. This could produce an outcome where an exposure to Counterparty A, reduced by SCRA on the basis of apportionment by relative EAD value, would not take the overall exposure to Counterparty A above the 25% large exposures limit; whereas if the SCRA were apportioned by RWA the value of the adjustment to Counterparty A could be lower because more has been apportioned to Counterparty B (which has a higher RWA than Counterparty A within the SCRA group) and this lower apportioned adjustment value allows the overall exposure to Counterparty A to exceed the 25% large exposures limit. This is a potential unintended consequence of the approach proposed by the EBA.

We look forward to working with the EBA in achieving its work programme and the full implementation of CRD IV.

Yours sincerely,

MPercival

Michael Percival
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afme/ Finance for Europe

Annex 1: AFME Proposed Amendments Relating to Credit Risk Adjustments

CRD IV Ref.	Commission Proposal	Drafting Suggestions	Comments
CRR Art 59	Tier 2 items shall consist of the following: (a) capital instruments, where the conditions laid down in Article 60 are met; (b) the share premium accounts related to the instruments referred to in point (a); (c) for institutions calculating risk-weighted exposure amounts in accordance with Chapter 2 of Title II, general credit risk adjustments, gross of tax effects, of up to 1.25 % of risk-weighted exposure amounts calculated in accordance with Chapter 2 of Title II of Part Three; (d) for institutions calculating risk-weighted exposure amounts under Chapter 3 of Title II, positive amounts, gross of tax effects, resulting from the calculation laid down in Article 154 and 155 up to 0,6 % of risk weighted exposure amounts calculated under Chapter 3 of Title II of Part Three.	Tier 2 items shall consist of the following: (a) capital instruments, where the conditions laid down in Article 60 are met; (b) the share premium accounts related to the instruments referred to in point (a); ~~(c) for institutions calculating risk-weighted exposure amounts in accordance with Chapter 2 of Title II, general credit risk adjustments, gross of tax effects, of up to 1.25 % of risk-weighted exposure amounts calculated in accordance with Chapter 2 of Title II of Part Three;~~ (d) for institutions calculating risk-weighted exposure amounts under Chapter 3 of Title II, positive amounts, gross of tax effects, resulting from the calculation laid down in Article 154 and 155 up to 0,6 % of risk weighted exposure amounts calculated under Chapter 3 of Title II of Part Three.	General credit risk adjustments should be effected symmetrically across the capital spectrum, including both for Core Equity Tier 1 and Tier 1 rather than just for Tier 2. The credit risk adjustment should be recognised to lower the exposure value and not admitted to Tier 2 capital. General credit risk adjustments are constituted through profit & loss and hence impact the Common Equity Tier 1 of the institution as well as the specific credit risk adjustments. They should be both deducted from the exposure value calculation. This proposed amendment in conformity with the current CRD rule. There is no rationale for the Commission proposal to modify this. Corresponding changes are proposed also for CRR Arts 105, 106, 241 and 261.
CRR Art 105 (1)	1. Institutions applying the Standardised Approach shall treat general credit risk adjustments in accordance with Article 59 (c). ...	~~1. Institutions applying the Standardised Approach shall treat general credit risk adjustments in accordance with Article 59 (c).~~ ...	Conforming change from CRR Art. 59.
CRR Art 106 (1)	1. The exposure value of an asset item shall be its accounting value remaining after specific credit risk adjustments have been applied. The exposure value of an off-balance sheet item listed in Annex I shall be the following percentage of its nominal value after reduction of specific credit risk adjustments: (a) 100 % if it is a full-risk item; (b) 50 % if it is a medium-risk item; (c) 20 % if it is a medium/low-risk item; (d) 0 % if it is a low-risk item. The off-balance sheet items referred to in the second sentence of the first subparagraph shall be assigned to risk categories as indicated in Annex I. When an institution is using the Financial Collateral Comprehensive Method under Article 218, the exposure value of securities or commodities sold, posted or lent under a repurchase transaction or under a securities or commodities lending or borrowing transaction, and margin lending transactions shall be increased by the volatility adjustment appropriate to such securities or commodities as prescribed in Articles 218 to 220. ...	1. The exposure value of an asset item shall be its accounting value remaining after ~~specific~~ credit risk adjustments have been applied. The exposure value of an off-balance sheet item listed in Annex I shall be the following percentage of its nominal value after reduction of ~~specific~~ credit risk adjustments: (a) 100 % if it is a full-risk item; (b) 50 % if it is a medium-risk item; (c) 20 % if it is a medium/low-risk item; (d) 0 % if it is a low-risk item. The off-balance sheet items referred to in the second sentence of the first subparagraph shall be assigned to risk categories as indicated in Annex I. When an institution is using the Financial Collateral Comprehensive Method under Article 218, the exposure value of securities or commodities sold, posted or lent under a repurchase transaction or under a securities or commodities lending or borrowing transaction, and margin lending transactions shall be increased by the volatility adjustment appropriate to such securities or commodities as prescribed in Articles 218 to 220. ...	Conforming change from CRR Art. 59.
CRR Art 241 (1)	1. The exposure value shall be calculated as follows: (a) where an institution calculates risk-weighted exposure amounts under Sub-section 3, the exposure value of an on-balance sheet securitisation position shall be its accounting value remaining after specific credit risk adjustments have been applied; (b) where an institution calculates risk-weighted exposure amounts under Sub-section 4, the exposure value of an on-balance sheet securitisation position shall be the accounting value measured without taking into account any credit risk adjustments made; (c) where an institution calculates risk-weighted exposure amounts under Sub-section 3, the exposure value of an off-balance sheet securitisation position shall be its nominal value, less any specific credit risk adjustment of that securitisation position, multiplied by a conversion factor as prescribed in this Chapter. The conversion factor shall be 100 % unless otherwise	1. The exposure value shall be calculated as follows: (a) where an institution calculates risk-weighted exposure amounts under Sub-section 3, the exposure value of an on-balance sheet securitisation position shall be its accounting value remaining after ~~specific~~ credit risk adjustments have been applied; (b) where an institution calculates risk-weighted exposure amounts under Sub-section 4, the exposure value of an on-balance sheet securitisation position shall be the accounting value measured without taking into account any credit risk adjustments made; (c) where an institution calculates risk-weighted exposure amounts under Sub-section 3, the exposure value of an off-balance sheet securitisation position shall be its nominal value, less any ~~specific~~ credit risk adjustment of that securitisation position, multiplied by a conversion factor as prescribed in this Chapter. The conversion factor shall be 100 % unless otherwise	Conforming change from CRR Art. 59.

CRD IV Ref.	Commission Proposal	Drafting Suggestions	Comments
	specified; (d) where an institution calculates risk-weighted exposure amounts under Sub-section 4, the exposure value of an off-balance sheet securitisation position shall be its nominal value multiplied by a conversion factor as prescribed in this Chapter. The conversion factor shall be 100 % unless otherwise specified; (e) The exposure value for the counterparty credit risk of a derivative instrument listed in Annex II, shall be determined in accordance with Chapter 6. The risk-weighted exposure amount of a securitisation position may be reduced by 12.5 times the amount of any specific credit adjustments made by the institution in respect of the position.	specified; (d) where an institution calculates risk-weighted exposure amounts under Sub-section 4, the exposure value of an off-balance sheet securitisation position shall be its nominal value multiplied by a conversion factor as prescribed in this Chapter. The conversion factor shall be 100 % unless otherwise specified; (e) The exposure value for the counterparty credit risk of a derivative instrument listed in Annex II, shall be determined in accordance with Chapter 6. The risk-weighted exposure amount of a securitisation position may be reduced by 12.5 times the amount of any ~~specific~~ credit adjustments made by the institution in respect of the position.	
CRR Art 261	1. The risk-weighted exposure amount of a securitisation position to which a 1250 % risk weight is assigned may be reduced by 12.5 times the amount of any specific credit adjustments made by the institution in respect of the securitised exposures. To the extent that specific credit adjustments are taken account of for this purpose they shall not be taken account of for the purposes of the calculation laid down in Article 155. 2. The risk-weighted exposure amount of a securitisation position may be reduced by 12.5 times the amount of any specific credit adjustments made by the institution in respect of the position....	1. The risk-weighted exposure amount of a securitisation position to which a 1250 % risk weight is assigned may be reduced by 12.5 times the amount of any ~~specific~~ credit adjustments made by the institution in respect of the securitised exposures. To the extent that ~~specific~~ credit adjustments are taken account of for this purpose they shall not be taken account of for the purposes of the calculation laid down in Article 155. 2. The risk-weighted exposure amount of a securitisation position may be reduced by 12.5 times the amount of any ~~specific~~ credit adjustments made by the institution in respect of the position....	Conforming change from CRR Art. 59.