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REPORT

from :	Presidency
to :	Permanent Representatives Committee
No. Cion prop.:	13284/11 EF 112 ECOFIN 531 CODEC 1284 + ADD1, ADD2 13285/11 EF 113 ECOFIN 532 CODEC 1285
Subject :	Legislative package on capital requirements and prudential supervision: a) Proposal for a Directive of the European Parliament and of the Council on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and amending Directive 2002/87/EC b) Proposal for a Regulation of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms

I. INTRODUCTION

1. The above mentioned Commission proposals have been transmitted to the Council on 20 July 2011. The objective of this legislative package is, *inter alia*, to ensure that the effectiveness of the regulation of credit institutions and investment firms in the EU is strengthened and that financial stability is enhanced as well as containing the pro-cyclicality of the financial system ensuring a high level of protection of investors and depositors and for the benefit of the operators on these markets. These proposals also aim to transpose the agreements reached by the Basel Committee on Banking Supervision (i.e. the Basel III requirements), as endorsed by the G20 leaders.

2. The Committee on Economic and Monetary Affairs of the European Parliament is expected to adopt its report on 25 April 2012. The Presidency has already pursued informal contacts with the European Parliament in order to facilitate reaching an agreement at first reading.
3. The European Central Bank delivered its opinion on the legislative package on 25 January 2012 (doc. 5876/12 EF 22 ECOFIN 78 CODEC 224). The opinion of the European Economic and Social Committee was issued on 18 January 2012.¹ The European Data Protection Supervisor has issued its opinion on 10 February 2012 (doc. 6808/12 ADD 1 EF 48 ECOFIN 182 DROIPEN 23 CODEC 463 ADD 1).
4. During the discussions at the Working Party on Financial Services the Presidency has tabled several compromise proposals in order to make progress on the file.

II. STATE OF PLAY

5. The latest Presidency compromise proposal was set out in docs. 8467/12 EF 84 ECOFIN 311 CODEC 904 and 8468/12 EF 85 ECOFIN 312 CODEC 905.² Following the meeting of the Working Party on 4 April 2012 there was not yet a qualified majority supporting an overall compromise mainly because of the following key outstanding issue:

a) Mechanism of the systemic risk buffer (Directive, Articles 124a, 124b and 124c); and country-specific prudential measures (Regulation, Articles 443a and 443b)

In order to address the call of most of the Member States for additional measures to respond better to systemic or macroprudential risks, the Presidency has proposed a threefold solution:

¹ OJ C 68, 6.3.2012, p. 39.

² NOTE: relevant excerpts from the last Presidency compromise text are copied in the Annex to this Report, without any changes.

- i) the draft Directive (Articles 124a, 124b and 124c) foresees that in addition to general own fund requirements to financial institutions, Member States could at national level impose **a systemic-risk buffer** of CET1 capital for domestic exposures. In general there is no cap on the level of the systemic-risk buffer. However, if the buffer requirement is set above 3%, the buffer is subject to prior approval by the Commission. Other Member States may voluntarily recognize that buffer requirement and apply it to domestically authorised institutions' exposures located in the Member State setting the buffer. Finally the compromise text provides an option for applying the buffer requirement to non-domestic exposures with prior approval of the Commission regardless of the size of the buffer requirement.
- ii) under the Regulation (Article 443a), subject to permission of the Commission (implementing act with opinions of ESRB and EBA), Member States would be able for up to two years (with a possibility to prolong for one additional year) to apply national measures that are more stringent than the general requirements set out in this legislative package as regards a) level of own funds, b) requirements for large exposures, c) public disclosure requirements and d) the level of the capital conservation buffer.
- iii) under the Regulation (Article 443b), the Commission, by way of a delegated act addressed to all Member States, would be able to impose stricter prudential requirements (level of own funds, requirements for large exposures and public disclosure requirements) for one year where this is necessary to address changes in the intensity of micro-prudential or macro-prudential risks which arise from market developments in at least [three Member States].

The thrust and the architecture of this compromise proposal are largely acceptable to Member States. However, some delegations still have concerns in particular with regard to the requirement for prior Commission approval of a systemic risk buffer requirement above 3 % and the treatment of non-domestic exposures in the systemic risk buffer (Directive Articles 124a and 124c).

To address the concern on prior Commission approval and taking into account expected positive developments in European capital markets it could be considered to allow buffer requirement for domestic exposures up to 5 % to be introduced by the Member states without prior Commission approval. This could be introduced from 2015 thereby providing Member States with more flexibility while ensuring the smooth functioning of the internal market.

Concerns are also raised with regards to the exact scope of the Commissions ability to impose stricter prudential measures (Regulation Article 443b). To address these concerns the scope of the provision could be limited to risks arising in all Member States instead of [3].

Besides this key outstanding issue there have been intensive discussions on the following three outstanding issues:

a) *Definition of Common Equity Tier 1 (CET1) items (Regulation, Article 24)*

The Presidency compromise text of the Regulation (Article 24(1)a) maintains that capital instruments are accepted as CET1 items, provided that the 14 criteria stated in Article 26 are met, but without necessarily the capital instruments in question constituting common shares *per se*. Member States would thus be able to recognise the forms of capital instruments which would be acceptable as CET1 instruments in their jurisdictions. The decisive criterion in that regard being not the **“form”** but the **“substance”** of the instrument in question (i.e. compliance with Article 26). This takes

into account the diversity of legal forms in Europe and the absence of an EU wide single definition of common shares. Nevertheless, Recital 53 states that it is expected that credit institutions and investment firms listed on an EU regulated market should meet their capital requirements with listed common shares that meet the 14 criteria. Furthermore article 75 states that EBA shall monitor the quality of own funds instruments issued by institutions across the Union and shall notify the Commission immediately when there is significant evidence of material deterioration in the quality of those instruments.

This substance over form approach is supported by a majority of the Member States as part of the overall compromise. However, a minority of Member States insist that the approach should be more aligned with the Basel III standard for international global banks, where the form of eligible CET1 instruments is essentially limited to common shares.

b) Financial conglomerates and investments in insurance companies (Regulation, Article 46)

On this issue, the Presidency compromise maintains the principle adopted in the Commission proposal, namely for the purposes of calculating own funds, competent authorities may permit institutions, which are financial conglomerates, to deduct **own funds instruments invested in the insurance sector** or under certain strict conditions to make use of the EU financial conglomerate consolidation methods (as permitted under the Financial Conglomerates Directive (FICOD)). This approach is supported by a qualified majority of the Member States as part of the overall agreement.

However, a few Member States insist that the approach on this issue should be more aligned with the Basel III standard, as revised in December 2011, not taking into account the treatment provided for by the FICOD Directive.

c) *Leverage ratio: disclosure and mandatory nature (Regulation, Article 436 and 482)*

The Presidency compromise follows the Commission proposal that the **legal regime of the leverage ratio** from 1 January 2018 would be determined by an ordinary legislative procedure on the basis of the Commission report due by end of 2016. Mandatory disclosure of this ratio would start in the EU from 1 January 2015.

Some delegations are against mandatory disclosure until the final decision on the calibration of the leverage ratio and whether the leverage ratio should be a binding requirement.

6. The Presidency believes that should an agreement be reached on these outstanding issues, as well as on certain previously recognized country-specific issues, the delegations would be in a position to lift their remaining reservations on the compromise text. Any outstanding technical issues should be solved in the following stages of negotiations on these texts.

III. CONCLUSION

7. Against this background the Permanent Representatives Committee is invited to:
 - resolve the outstanding issues and agree on the general approach with regard to the proposed legislative package on capital requirements and prudential supervision;
 - recommend to the Council to:
 - a) confirm the agreement on the general approach;
 - b) invite the Presidency to start negotiations with the European Parliament on the basis of this general approach with a view to reaching an agreement at first reading.

Excerpts from documents No. 8467/12 and No. 8468/12**1. DIRECTIVE, ARTICLES FROM 124a TO 124c***Article 124a**Requirement to maintain a Systemic Risk Buffer*

1. Each Member State may introduce a Systemic Risk Buffer of Common Equity Tier 1 for the banking sector or one or more subsets of the sector.

1a. For the purpose of paragraph 1, the Member State shall designate the authority in charge of the application of this Article. This authority shall be the competent authority or the designated authority.

2. [...] For the purpose of paragraph 1, the [...] authority determined according to paragraph 1a may require [...] institutions to maintain, in addition to the Common Equity Tier 1 capital maintained to meet the own funds requirement imposed by Article 87 of Regulation [insert by OP], a Systemic Risk Buffer of Common Equity Tier 1 capital.

2a. Institutions shall not use Common Equity Tier 1 capital that is maintained to meet the requirement under paragraph 2 to meet any requirements imposed under Article 87 of Regulation [insert by OP] and Article 123, 124 and any requirements imposed under Article 99 and 100. [...] 3. The Systemic Risk Buffer requirement shall apply to exposures located in that Member State and third-countries in accordance with the methodology laid down in accordance with Article 130(4) and 130(5) including exposures under Article 107 (f) of the Regulation [insert by OP] in order to prevent and mitigate long term non cyclical systemic or macroprudential risk not covered by Regulation [insert by OP] [...], in the meaning of a risk of disruption in the financial system with the potential to have serious negative consequences to the financial system and the real economy in a specific Member State. [...] 3b. The Systemic Risk Buffer Rate shall apply to all institutions, or one or more subsets of those institutions, for which the authorities of the Member State

concerned are competent in accordance with this Directive and shall be set in gradual or accelerated steps of adjustment of 0,5 percentage point. There can be introduced different requirements for different subsets of the sector.

4. [...]

5. When requiring a Systemic Risk Buffer [...] the authority [...] determined according to paragraph 1a [...] shall respect the following principles:

[...] a) the Systemic Risk Buffer requirement may not entail disproportionate adverse effects on the whole or parts of the financial system in other Member States or of the EU as a whole forming or creating an obstacle to the functioning of the internal market;

[...] b) [...]

c) the Systemic Risk Buffer requirement shall be reviewed by [...] the authority determined according to paragraph 1a at least every second year [...].

6. [...] Before setting or resetting a Systemic Risk Buffer requirement of up to 3 %, the [...] authority determined according to paragraph 1a shall notify the Commission, [...] EBA, [...] the ESRB [...] and competent authorities of concerned Member States 1 months prior to the publication of the decision referred to in paragraph 10. If the buffer requirement apply to exposures located in third-countries the authority determined according to paragraph 1a shall also notify the competent authorities of those third-countries. This notification shall describe in detail the following elements:

a) the systemic or macro-prudential risk in the Member State;

b) the reasons why [...] the dimension of systemic and macro-prudential risks poses a threat to financial stability at national level;

c) the justification for why the measures proposed are deemed effective and proportionate to mitigate the intensity of risk;

- d) an assessment [...] of the likely impact of the measures on the single market based on information which is available to the Member State; [...]
- e) the justification for why any of the existing measures in the Regulation, excluding Article 443A and 443B, or the Directive [insert by OP] alone or in a combination will not be sufficient to address the identified macro-prudential [...] or systemic risk taking into account the relative effectiveness of these measures; [...]
- ei) the Systemic Risk Buffer rate that the Member State wish to require.

7. [...] Before setting or resetting a Systemic Risk Buffer requirement of above 3 %, the [...] authority [...] determined according to paragraph 1a shall notify the Commission, [...] EBA, [...] the ESRB [...] and competent authorities of concerned Member States [...]. If the buffer requirement apply to exposures located in third-countries the authority determined according to paragraph 1a shall also notify the competent authorities of those third-countries. This notification shall describe in detail the following elements:

- a) the systemic or macro-prudential risk in the Member State;
- b) the reasons why [...] the dimension of the systemic or macro-prudential risks poses a threat to financial stability at national level justifying the level of the Systemic Risk Buffer requirement;
- c) the justification for why the measures proposed are deemed effective to mitigate the intensity of risk;
- d) [...] an assessment of the likely impact of the measures on the single market based on information which is available to the Member State.

e) the justification for why any of the existing measures in the Regulation excluding Article 443A and 443B or the Directive [insert by OP] alone or in a combination will not be sufficient to address the identified macro-prudential [...] or systemic risk taking into account the relative effectiveness of these measures; [...]

ei) the Systemic Risk Buffer rate that the Member State wish to require.

8. Within [[...] 4 weeks] from the notification [...] referred to in [...] paragraph 7, the ESRB shall provide the Commission with an opinion as to whether the Systemic Risk Buffer requirement is deemed appropriate. [...] EBA may also provide the Commission with its opinion on the buffer in accordance with Article 34(1) of Regulation (EU) No. 1093/2010.

Within two month following the notification, the Commission, taking into account the assessment of ESRB and EBA, if relevant, and if it is satisfied that the Systemic Risk Buffer requirement does not entail disproportionate adverse effects on the whole or parts of the financial system in other Member States or of the EU as a whole forming or creating an obstacle to the functioning of the internal market, shall adopt an implementing act authorising the authority determined according to paragraph 1a to adopt the proposed measure.

9. [...]

[...]

10. Each [...] authority [...] determined according to paragraph 1a shall announce the setting of the Systemic Risk Buffer requirement by publication on an appropriate web site. The announcement shall at least include the following information:

a) the level of the applicable Systemic Risk Buffer;

ai) the institutions which shall comply with the buffer requirement;

b) a justification for the Systemic Risk Buffer requirement c) the date from which the institutions must apply the setting or resetting of the Systemic Risk Buffer;

c) *the date from which the institutions must apply the setting or resetting of the Systemic Risk Buffer; and*

d) the names of the countries where exposures located in these countries are recognised in the systemic buffer.

If the publication referred to in paragraph 10 point b [...] could jeopardise financial stability [...], the required information in paragraph 10 point b shall not be included in the announcement.

11. Where an institution fails to meet fully the requirement under paragraph 1, it shall be subject to the restrictions on distributions set out in paragraphs 2 and 3 of Article 131.

Where the application of these restrictions on distributions leads to an unsatisfactory improvement of the Common Equity Tier 1 of the institution in the light of the relevant systemic risk, the competent authorities may take additional measures according to Article 64 of this Directive.

Article 124b

Recognition of a Systemic Risk Buffer

- 1. Other Member States may recognise the Systemic Risk buffer rate set according to Article 124a and apply that buffer rate to domestically authorised institutions for the exposures located in the Member State setting the buffer.**
- 2. If Member States recognise the Systemic Risk Buffer requirement for domestically authorised institutions the Member State shall notify the Commission, EBA, the ESRB and the Member State setting the Systemic Buffer requirement.**
- 3. When deciding whether to recognise a Systemic Risk Buffer the Member State shall take into consideration the information presented by the Member State setting the buffer according to paragraph 10 of Article 124a.**
- 4. The Member State setting the buffer according to Article 124a may ask the ESRB to issue a recommendation as referred to in Article 16 of Regulation (EU) No. 1092/2010 to Member States which recognise the Systemic Risk Buffer.**

Article 124c

Exposures located in other Member States in the Systemic Risk Buffer

- 1. When setting or resetting a Systemic Risk Buffer according to Article 124a the authority determined according to paragraph 1a in Article 124a may include exposures located in other Member States.**
- 2. Before setting or resetting a Systemic Risk Buffer where exposures in other Member States are included, the authority determined according to paragraph 1a in Article 124a shall follow the procedure specified in paragraph 1-5 and 7-11 of Article 124a regardless of the size of the buffer requirement.**
- 3. If exposures are subject to different Systemic Risk Buffer requirements according to this Article and Article 124b, the requirements set accordingly to this Article will prevail.**

REGULATION, ARTICLES 443a AND 443b

Article 443a

Macro-prudential **or systemic** risk identified at the level of a Member State

1. If Member State designated **[...] authority identifies** changes in the intensity of macro-prudential **or systemic** risk **[...] in the meaning of a risk of disruption in the [...]** financial **[...] system with the potential to have serious negative consequences to the financial system and the real economy in a specific** Member State wants **[...] which the designated authority considers would better be addressed by means of national measures, it** shall notify the Commission, **the Council, [...]** the ESRB **and EBA** of that fact and submit relevant evidence **[...]** :
 - a) the changes in the intensity of macro-prudential **or systemic** risk;

- b) the reasons why such changes **could** pose a threat to financial stability at national level; [...] be) **a justification of why Articles 119 and 160 of this Regulation and Articles 98, 99a, 100, 100a, 124a, and 126 of Directive [inserted by OP] cannot adequately address the identified macro-prudential or systemic risk taken into account the relative effectiveness of these measures.**
- c) draft national measures **for domestically authorised institutions, or a subset of those institutions,** to mitigate the changes in the intensity of risk [...]:
 - (i) the level of own funds laid down in Article 87;
 - (ii) the requirements for large exposures laid down in Article 381 and Article 384 to 392;
 - (iii) the public disclosure requirements laid down in articles 418 to 440;
 - (iv) **the level of the conservation buffer as set out in Article 123 of the Directive [inserted by OP]. [...]**
- d) an explanation as to why such draft measures are deemed by the designated authorities to be suitable, [...], effective **and proportionate** to address the situation.
- e) **an assessment [...] of [...] the likely impact of the measures on the single market based on information which is available to the Member State.**

1a. When authorised to apply national measures in accordance with this Article Member States shall provide relevant competent authorities with all relevant information.

- 2. Within one month of receiving the notification referred to in paragraph 1 the ESRB and EBA shall provide its opinion on the points mentioned in paragraph 1 to the Commission. After receiving the opinion, the Commission shall within one month adopt an implementing act to allow the relevant Member State designated authority to address the threat by an individual measure as set out in paragraph (1)(c) for a period of up to two years if it is satisfied that:**
- a) the changes in the intensity of macro-prudential or systemic risk are of such nature as to pose risk to financial stability at national level;**
 - b) Articles 119 and 160 of this regulation [...] the Articles 98, 99a, 100, 100a, 124a, and 126 [...] of Directive [inserted by OP] cannot adequately address the identified macro-prudential or systemic risk taken into account the relative effectiveness of these measures.**
 - c) the proposed national measures are more suitable to address the identified macro-prudential or systemic risk and do not entail disproportionate adverse effects on the whole or parts of the financial system in other Member States or of the EU as a whole, thus forming or creating an obstacle to the functioning of the internal market;**
 - d) the issue concerns only one Member State**
 - e) the risks have not already been addressed by measures in this Regulation or the Directive [inserted by OP]**

[...]

The assessment of the Commission shall **take account of the opinion of the ESRB and EBA and shall be [...]** based on the evidence presented by designated authorities in accordance with paragraph 1. **[...]**

3. The Commission shall [...] in consultation with the ESRB and **EBA review at least every second year the situation and** may accordingly adopt **[...] , in accordance with the procedure referred to in paragraph 2, a new decision for the extension of** the period of application of national measures for one additional year each time.

Article 443b

Prudential requirements

The Commission shall be empowered to adopt delegated acts in accordance with Article 445, to impose, **for a period of one year,** stricter prudential requirements [...] [...] for [...] exposures [...] [...] where this is necessary to address changes in the intensity of micro-prudential and macro-prudential risks which arise from market developments **[...] in at least [three] Member States or outside the Union affecting at least [three] Member States,** and where the instruments of this Regulation and the Directive [[...] inserted by OP] are not sufficient to address these risks, in particular upon the recommendation or opinion of the ESRB or EBA, concerning

- (a) the level of own funds laid down in Article 87;
- (b) the requirements for large exposures laid down in Article 381 and Article 384 to 392
- (c) the public disclosure requirements laid down in articles 418 to 440.

This delegation of power shall be subject to the procedure referred to in Article 445 **[...]**

The Commission assisted by the ESRB shall, at least on an annual basis, submit to the European Parliament and the Council, a report on market developments potentially requiring the use of Article 443B.

[...]

2. REGULATION, RECITAL 53 AND ARTICLES 24 AND 26

“(53) In light of the nature and magnitude of unexpected losses experienced by credit institutions and investment firms during the financial and economic crisis, it is necessary to improve further the quality and harmonisation of own funds that credit institutions and investment firms are required to hold. This should include the introduction of a new definition of the core elements of capital available to absorb unexpected losses as they arise, enhancements to the definition of hybrid capital and uniform prudential adjustments to own funds. It is also necessary to raise significantly the level of own funds, including new capital ratios focusing on the core elements of own funds available to absorb losses as they arise. It is expected that credit institutions or investment firms whose shares are listed on an EU regulated market should meet their capital requirements regarding the core elements of capital with these listed common shares that meet a strict set of criteria for the core capital instruments and the disclosed reserves of the institution only. In order to adequately take into account the diversity of legal forms credit institutions and investment firms in the European Union are operating under, the strict set of criteria for the core capital instruments will ensure that core capital instruments for institutions not listed on an EU regulated market are of highest quality. [...]

/.../

Article 24
Common Equity Tier 1 items

1. Common Equity Tier 1 items of institutions consist of the following:
 - (a) capital instruments, provided the conditions laid down in Article 26 are met;
 - (b) share premium accounts related to the instruments referred to in point (a);
 - (c) retained earnings;
 - (d) accumulated other comprehensive income;
 - (e) other reserves;
 - (f) funds for general banking risk.
2. For the purposes of point (c) of paragraph 1, institutions may include interim or year-end profits in Common Equity Tier 1 capital before the institution has taken a formal decision confirming the final profit or loss of the institution for the year only with the prior consent of the competent authority. The competent authority shall consent where the following conditions are met:
 - (a) those profits have been verified by persons independent of the institution that are responsible for the auditing of the accounts of that institution;
 - (b) the institution has demonstrated to the satisfaction of the competent authority that any foreseeable charge or dividend has been deducted from the amount of those profits.

A review of the interim or year-end profits of the institution shall provide an adequate level of assurance that those profits have been evaluated in accordance with the principles set out in the applicable accounting **framework [...]**.

3. EBA shall develop draft regulatory technical standards to specify the meaning of foreseeable when determining whether any foreseeable charge or dividend has been deducted.

EBA shall submit those draft regulatory technical standards to the Commission by 1 January 2013.

Power is delegated to the Commission to adopt the regulatory technical standards referred to in the first subparagraph in accordance with the procedure laid down in Articles 10 to 14 of Regulation (EU) No 1093/2010.

4. **On the basis of information from each Member State,** EBA shall establish, maintain and publish a list of the forms of capital instruments, **which the Member State in its jurisdiction considers [...]** as Common Equity Tier 1 instruments. **[...] [...] [...]** EBA shall establish and publish this list for the first time by 1 January 2013.

/.../

Article 26

Common Equity Tier 1 instruments

1. Capital instruments shall qualify as Common Equity Tier 1 instruments only if all the following conditions are met:
- (a) the instruments are issued directly by the institution with the prior approval of the owners of the institution or, where permitted under applicable national law, the management body of the institution;
 - (b) the instruments are paid up and their purchase is not funded directly or indirectly by the institution;

- (c) the instruments meet all the following conditions as regards their classification:
 - (i) they qualify as capital within the meaning of Article 22 of Directive 86/635/EEC;
 - (ii) they are classified as equity within the meaning of the applicable accounting standard;
 - (iii) they are classified as equity capital for the purposes of determining balance sheet insolvency, where applicable under national insolvency law;
- (d) the instruments are clearly and separately disclosed on the balance sheet in the financial statements of the institution [...] , which in the case of institutions subject to statutory audit shall be the balance sheet subject to that audit; ;
- (e) the instruments are perpetual;
- (f) the principal amount of the instruments may not be reduced or repaid, except in either of the following cases:
 - (i) the liquidation of the institution;
 - (ii) discretionary repurchases of the instruments or other discretionary means of reducing capital, where the institution has received the prior consent of the competent authority in accordance with Article 72;
- (g) the provisions governing the instruments do not indicate expressly or implicitly that the principal amount of the instruments would or might be reduced or repaid other than in the liquidation of the institution, and the institution does not otherwise provide such an indication prior to or at issuance of the instruments, except in the case of instruments referred to in Article 25 where the refusal by the institution to redeem such instruments is prohibited under applicable national law;

- (h) the instruments meet the following conditions as regards distributions:
- (i) there are no preferential distributions, including in relation to other Common Equity Tier 1 instruments, and the terms governing the instruments do not provide preferential rights to payment of distributions;
 - (ii) distributions to holders of the instruments may be paid only out of distributable items, which are limited to the profit of the period for which the distribution is paid plus any reserves which according to national company law may be distributed following a decision of the owners of the institution;
 - (iii) the conditions governing the instruments do not include a cap or other restriction on the maximum level of distributions, except in the case of the instruments referred to in Article 25;
 - (iv) the level of distributions is not determined on the basis of the amount for which the instruments were purchased at issuance, except in the case of the instruments referred to in Article 25;
 - (v) the conditions governing the instruments do not include any obligation for the institution to make distributions to their holders and the institution is not otherwise subject to such an obligation;
 - (vi) non-payment of distributions does not constitute an event of default of the institution;
 - (vii) the cancellation of distributions imposes no restrictions on the institution ;

- (i) compared to all the capital instruments issued by the institution, the instruments absorb the first and proportionately greatest share of losses as they occur, and each instrument absorbs losses to the same degree as all other Common Equity Tier 1 instruments;
- (j) the instruments rank below all other claims in the event of insolvency or liquidation of the institution;
- (k) the instruments entitle their owners to a claim on the residual assets of the institution, which, in the event of its liquidation and after the payment of all senior claims, is proportionate to the amount of such instruments issued and is not fixed or subject to a cap, except in the case of the capital instruments referred to in Article 25;
- (l) the instruments are not secured, or subject to a guarantee that [...] enhances the seniority of the claim [...] by any of the following:
 - (i) the institution or its subsidiaries;
 - (ii) the parent undertaking of the institution or its subsidiaries;
 - (iii) [...]
 - (iv) [...]
 - (v) [...]
 - (vi) any undertaking that has close links with the entities referred to in points (i) or (ii) ;
- (m) the instruments are not subject to any arrangement, contractual or otherwise, that enhances the seniority of claims under the instruments in insolvency or liquidation.

2. The conditions laid down in point (i) of paragraph 1 shall be met notwithstanding a write down on a permanent basis of the principal amount of Additional Tier 1 instruments.
3. EBA shall develop draft regulatory technical standards to specify the following:
 - (a) the applicable forms and nature of indirect funding of capital instruments;
 - (b) [...].

EBA shall submit those draft regulatory technical standards to the Commission by 1 January 2013.

Power is delegated to the Commission to adopt the regulatory technical standards referred to in the first subparagraph in accordance with the procedure laid down in Articles 10 to 14 of Regulation (EU) No 1093/2010.

3. REGULATION, ARTICLE 46

Article 46

Requirement for deduction where consolidation, supplementary supervision or institutional protection schemes are applied

1. For the purposes of calculating own funds on a stand-alone basis, a subconsolidated basis and a consolidated basis, where the competent authorities require or permit institutions to apply methods 1 or 2 of Annex I to Directive 2002/87/EC, the competent authorities may permit institutions not to deduct the holdings of own funds instruments of a financial sector entity in which the parent institution, parent financial holding company or parent mixed financial holding company or institution has a significant investment, provided that the conditions laid down in points (a) to (e) are met:
 - (a) the financial sector entity is an insurance undertaking, re-insurance undertaking or an insurance holding company;
 - (b) that insurance undertaking, re-insurance undertaking or an insurance holding company is included in the same supplementary supervision under Directive 2002/87/EC as the parent institution, parent financial holding company or parent mixed financial holding company or institution that has the holding;
 - (c) the institution has received the prior permission of the competent authorities;
 - (d) prior to granting the permission referred to in point (c), and on a continuing basis, the competent authorities are satisfied that the level of integrated management, risk management and internal control regarding the entities that would be included in the scope of method 1 or 2 is adequate;

(e) the **holdings in the entity belongs to [...]** one of the following:

(i) the parent credit institution;

(ii) the parent financial holding company;

(iii) the parent mixed financial holding company;

(iv) the institution;

(v) a subsidiary of one of the entities referred to in points (i) to (iv) that is included in the scope of consolidation pursuant to Chapter 2 of Title II of Part One.

The method chosen shall be applied in a consistent manner over time.

2. For the purposes of calculating own funds on a stand-alone basis and a sub-consolidated basis, institutions subject to supervision on a consolidated basis in accordance with Chapter 2 of Title II of Part One shall not deduct holdings referred to in points (h) and (i) of Article 33(1) in financial sector entities included in the scope of consolidated supervision
3. Competent authorities may permit institutions not to deduct a holding of an item referred to in points (h) and (i) of Article 33(1) in the following cases:
 - (a) [...]
 - (b) where an institution referred to in Article 25 has a holding in another such institution, or in its central or regional credit institution, and the following conditions are met:
 - (ii) the institutions fall within the same institutional protection scheme referred to in Article 108(7);
 - (iii) the competent authorities have granted the permission referred to in Article 108(7);

- (iv) the conditions laid down in Article 108(7) are satisfied;
- (v) the institution draws up and reports to the competent authorities the consolidated balance sheet referred to in point (e) of Article 108(7) no less frequently than own funds requirements are required to be reported under Article 95.
- (vi) the institutions included in each institutional protection scheme meet **together** on a consolidated basis the requirements laid down in Article 87, **in Article 100 of the Directive and in Title VI, Chapter 4 of the Directive**; and carry out reporting of compliance with those requirements in accordance with Article 95.
- (c) where a regional credit institution has a holding in its central or another regional credit institution and the conditions laid down in point (b)(i) to (vi) are met.

3a. The holdings in respect of which deduction is not made in accordance with paragraphs 1, 2 or 3 shall qualify as equity exposures and be risk weighted in accordance with Chapter 2 or 3 of Title II of Part Three, as applicable.

- 4. EBA, EIOPA and ESMA shall, through the Joint Committee, develop draft regulatory technical standards to specify for the purposes of this Article the conditions of application of the calculation methods listed in Annex I, Part II and Article 228(1) of Directive 2002/87/EC for the purposes of the alternatives to deduction referred to in paragraph 1 and point (a) of paragraph 3.

EBA, EIOPA and ESMA shall submit those draft regulatory technical standards to the Commission by 1 January 2013.

Power is delegated to the Commission to adopt the regulatory technical standards referred to in the first sub-paragraph in accordance with the procedure laid down in Articles 10 to 14 of Regulation (EU) No 1093/2010.

5. EBA shall develop draft regulatory technical standards to specify the conditions of application of paragraph 3 **to specify the conditions of application of points (v) and (vi) of paragraph 3(b).**

EBA shall submit those draft regulatory technical standards to the Commission by 31 January 2013.

Power is delegated to the Commission to adopt the regulatory technical standards referred to in the first sub-paragraph in accordance with the procedure laid down in Articles 10 to 14 of Regulation (EU) No 1093/2010.

4. REGULATION, ARTICLES 436 AND 482

Article 436

Leverage

1. Institutions shall disclose the following information regarding their leverage ratio as defined in Article 416 and their management of the risk of excessive leverage as defined in point (B) of Article 4(2) of Directive [inserted by OP]:
 - (a) the leverage ratio and how the institution applied Article 475, paragraph 2 and 3;
 - (b) a breakdown of the total exposure measure
 - (ba) where applicable, the amount of derecognised fiduciary items according to Article 416 paragraph 11;**
 - (c) a description of the processes used to manage the risk of excessive leverage;
 - (d) a description of the factors that had an impact on the leverage ratio during the period to which the disclosed leverage ratio refers.
2. EBA shall develop draft implementing technical standards to determine the uniform disclosure template for the disclosure referred to in paragraph 1 and the instructions on how to use such template.

EBA shall submit those draft implementing technical standards to the Commission by 30 June 2014.

Power is conferred on the Commission to adopt the implementing technical standards referred to in the first subparagraph in accordance with the procedure laid down in Article 15 of Regulation (EU) No 1093/2010.

/.../

Article 482

Leverage

1. Based on the results of the report in paragraph 2, the Commission shall submit by 31 December 2016 a report on the impact and effectiveness of the leverage ratio to the European Parliament and the Council. Where appropriate, the report shall be accompanied by a legislative proposal on the introduction of one or more levels of the leverage ratio that different types of institutions would be required to meet, suggesting an adequate calibration for those levels and any appropriate adjustments to the capital measure and the total exposure measure as defined in Article 416, **together with any connected flexibility measures if necessary, including the possible introduction of those leverage ratio levels in Articles 443A and 443B.**
2. For the purposes of paragraph 1, the EBA shall report to the Commission by 31 October 2016 on at least the following:
 - a0) Whether the leverage ratio framework provided by this Regulation **and article 85 and article 94 of the Directive [inserted by OP]** is the appropriate tool [...] to suppress the risk of excessive leverage on the part of the institutions in a satisfactory manner and degree;
 - (a) whether the requirements laid out in Articles 75 and 85 of Directive [inserted by OP] in accordance with Articles 72 and 92 of Directive [inserted by OP] for addressing the risk of excessive leverage ensure sound management of this risk by institutions and, if not, which further enhancement they need in order to ensure these objectives;
 - (b) whether – and if so, which - changes to the calculation methodology detailed in Article 416 would be necessary to ensure that the leverage ratio can be used as an appropriate indicator of an institution's risk of excessive leverage;

- (c) whether, in the context of the calculation of the total exposure measure of the leverage ratio, the exposure value of items listed in Annex II determined by using the Original Exposure Method differs in a material way from the exposure value determined by using the Mark-to-Market Method;
- (d) whether using either own funds or Common Equity Tier 1 capital as the capital measure of the leverage ratio could be more appropriate for the intended purpose of tracking the risk of excessive leverage and, if so, what would be the appropriate calibration of the leverage ratio;
- (e) whether the percentage referred to in point (a) of article 416(8) for undrawn credit facilities, which may be cancelled unconditionally at any time without notice, is appropriately conservative based on the evidence collected during the observation period;
- (f) whether the frequency and format of the disclosure of items referred to in Article 436 are adequate;
- (g) whether 3% would be an appropriate level for the leverage ratio based on Tier 1 capital and, if not, what level would be the appropriate one;
- (h) whether introducing the leverage ratio as a requirement for institutions would necessitate any changes to the leverage ratio framework provided by this Regulation and, if so, which ones;
- (i) whether introducing the leverage ratio as a requirement for institutions would effectively constrain the risk of excessive leverage on the part of those institutions and, if so, whether the level for the leverage ratio should be the same for all institutions or should differ for different types of institution and, in the latter case, what additional calibrations would be required.

3. The report referred to in paragraph 2 shall cover at least the period from 1 January 2013 until 30 June 2016 and shall take account of at least the following:
- (a) the impact of introducing the leverage ratio, determined in accordance with Article 416, as a requirement that institutions would have to meet on:
 - (i) financial markets in general and markets for repurchase transactions, derivatives and covered bonds in particular;
 - (ii) the robustness of institutions;
 - (iii) business models and balance-sheet structures of institutions;
 - (iv) the migration of exposures to entities which are not subject to prudential supervision;
 - (v) financial innovation, in particular the development of instruments with embedded leverage;
 - (vi) institutions' risk-taking behaviour;
 - (vii) clearing, settlement and custody activities;
 - (viii) cyclicalities of the capital measure and the total exposure measure of the leverage ratio;
 - (ix) bank lending, with a particular focus on lending to small and medium enterprises and on trade financing, including lending under official export credit insurance schemes;
 - (b) the interaction of the leverage ratio with the risk-based own funds requirements and the liquidity requirements as specified in this Regulation;

- (c) the impact of accounting differences between accounting standards applicable under Regulation (EC) No 1606/2002, accounting standards applicable under Directive 86/635/EC and other **[...] applicable** accounting standards on the comparability of the leverage ratio.

3a. [...]
