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COVER NOTE

From:	Secretary-General of the European Commission, signed by Mr Jordi AYET PUIGARNAU, Director
date of receipt:	30 January 2015
To:	Mr Uwe CORSEPIUS, Secretary-General of the Council of the European Union

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Subject:	COMMISSION DELEGATED REGULATION (EU) No .../.. of 30.1.2015 amending Delegated Regulation (EU) No 241/2014 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for Own Funds requirements for institutions
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Delegations will find attached document C(2015) 361 final.

Encl.: C(2015) 361 final



Brussels, 30.1.2015
C(2015) 361 final

COMMISSION DELEGATED REGULATION (EU) No .../..

of 30.1.2015

amending Delegated Regulation (EU) No 241/2014 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for Own Funds requirements for institutions

(Text with EEA relevance)

EXPLANATORY MEMORANDUM

1. CONTEXT OF THE DELEGATED ACT

Article 28(5) of Regulation (EU) No 575/2013 ('the Regulation') empowers the Commission to adopt, following submission of draft standards by the European Banking Authority (EBA), and in accordance with Articles 10 to 14 of Regulation No (EU) 1093/2010, delegated acts specifying certain provisions relating to regulatory own funds.

In accordance with Article 10(1) of Regulation (EU) No 1093/2010 establishing the EBA, the Commission shall decide within three months of receipt of the draft standards whether to endorse the drafts submitted. The Commission may also endorse the draft standards in part only, or with amendments, where the Union's interests so require, having regard to the specific procedure laid down in those Articles.

2. CONSULTATIONS PRIOR TO THE ADOPTION OF THE ACT.

In accordance with the third subparagraph of Article 10(1) of Regulation No (EU) 1093/2010, the EBA has carried out a public consultation on the draft technical standards submitted to the Commission in accordance with Article 28(5) of the Regulation. A consultation paper was published on the EBA internet site on 23 May 2013, and the consultation closed on 18 July 2013. Moreover, the EBA invited the EBA's Banking Stakeholder Group set up in accordance with Article 37 of Regulation No (EU) 1093/2010 to provide advice on them. Together with the draft technical standards, the EBA has submitted an explanation on how the outcome of these consultations has been taken into account in the development of the final draft technical standards submitted to the Commission.

Together with the draft technical standards, and in accordance with the third subparagraph of Article 10(1) of Regulation No (EU) 1093/2010, the EBA has submitted its Impact Assessment, including its analysis of the costs and benefits related to the draft technical standards submitted to the Commission. This analysis is available at <https://www.eba.europa.eu/regulation-and-policy/own-funds/draft-regulatory-technical-standards-on-own-funds/-/regulatory-activity/consultation-paper>, pages 20-26 of the Final Draft RTS package.

3. LEGAL ELEMENTS OF THE DELEGATED ACT

In this particular area of own funds, the mandate is twofold: one is related to multiple distributions and the other one to preferential distributions, which have been considered separately for joint-stock companies and non joint-stock companies. The provisions of this delegated act specify, in particular, whether and when multiple distributions would create a disproportionate drag on capital, and clarify the meaning of preferential distributions - namely preferential rights to payments of distributions and order of payments of distribution.

Capital instruments may include provisions that give rise to distributions that are a multiple of the distributions paid on voting Common Equity Tier 1 (CET1) instruments (multiple distributions). However, only a subset of those instruments would be considered not to create a disproportionate drag on capital, and could therefore be included in CET1.

This delegated act aims at specifying harmonised criteria which are to be met by those instruments that are to be included in CET1, so as to ensure that the future loss absorbency of CET1 instruments is in no way compromised by disproportionate distributions that would create a drag on capital. In this respect, quantitative limits are set. These limits are expressed (i) in terms of the amount of distribution on one non-voting instrument and (ii) in terms of the total amount of distributions paid on CET1 instruments. These criteria are restricted to joint stock companies.

Preferential distributions exist when holders of CET1 instruments have an advantage compared with other holders of CET1 instruments of the same institution, particularly regarding the timing and order of distribution payments. In addition, also those instruments where the distributions exceed the limits set with respect to multiple distributions are considered as preferential. In clarifying the definition of preferential distributions, this delegated act aims at ensuring equal treatment among CET1 holders.

For joint stock companies, the approach is the same as for multiple distributions. For non-joint stock companies, and in order to take into account the specific features of this type of institutions, the approach is based on a set of criteria not strictly based on hard quantitative limits but on a combination of different factors related to the general features of instruments issued by non-joint stock companies. These criteria reflect, in particular, the nature of the holders of the non-voting instruments, the existence of a legal cap on the voting instruments, the voting rights and the average level of distributions.

Finally, this delegated act also specifies the extent of the consequences of not meeting the above-mentioned criteria, as provided for in the Regulation in terms of (dis)qualification of instruments as Common Equity Tier 1 (CET 1) capital.

COMMISSION DELEGATED REGULATION (EU) No .../..

of 30.1.2015

amending Delegated Regulation (EU) No 241/2014 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for Own Funds requirements for institutions

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012¹, and in particular the third subparagraph of Article 28(5) thereof,

Whereas:

- (1) The drag on own funds should not be disproportionate in terms of both the distributions on any individual Common Equity Tier 1 instrument as well as the distributions on the total own funds of the institution. Therefore, the notion of a disproportionate drag on own funds should be established by providing rules covering both of these aspects.
- (2) The mandate on the potential disproportionate drag on own funds set out in Article 28(5)(b) of Regulation (EU) No 575/2013 does not cover instruments falling under Article 27 of that Regulation since those are exempted by virtue of Article 28(1)(h)(iii) of that Regulation.
- (3) The meaning of preferential distributions should be based on features of the instruments that reflect the requirements of Article 28(1)(h)(i) of Regulation (EU) No 575/2013 that no preferential distribution treatment regarding the order of the distributions or other preferential rights should exist, including for preferential distributions of Common Equity Tier 1 instruments in relation to other Common Equity Tier 1 instruments. Given that Article 28(h)(i) of Regulation (EU) No 575/2013 distinguishes between preferential rights to payment of distributions and preferences regarding the order of distribution payments, rules on preferential distributions should cover both cases.
- (4) Different rules should apply to the Common Equity Tier 1 instruments of institutions referred to in Article 27 of Regulation (EU) No 575/2013 ('non-joint stock

¹ OJ L 176, 27.6.2013, p. 1.

companies') where justified by specific features of voting instruments and non-voting instruments. Where only the holders of the voting instruments may subscribe to the non-voting shares, then there is no deprivation of voting rights for holders of non-voting instruments. Therefore, the differentiated distribution on the non-voting instrument of non-joint stock companies is not driven by the absence of a voting right in the same way as for joint stock companies. Also, when there is a cap on the distribution of the voting instrument set under applicable national law, the limits devised for joint stock companies should be replaced by other rules that ensure the absence of a preferential right to payment of distributions.

- (5) A different treatment for non-joint stock companies is only justified if the former institutions do not issue capital instruments with a predetermined multiple distribution that would be set contractually or in the statutes of the institution. If they do, concerns relating to the preferential right to payment of distributions are the same as for joint stock companies and the same treatment should therefore apply.
- (6) This should not prevent non-joint stock companies from issuing other capital instruments with differentiated distribution provided that they demonstrate that those instruments do not create a preferential right to payment of distributions. This demonstration should be based on the assessment of the level of distributions on voting instruments and the level of distributions on total Common Equity Tier 1. The institution should demonstrate that the level of distributions on the voting instruments is low by reference to other capital instruments and that the pay-out ratio on Common Equity Tier 1 instruments is low.
- (7) In order for non-joint stock companies to assess whether the level of the pay-out ratio is low, a benchmark should be established. In order to take into account that pay-out ratios may fluctuate depending on the yearly result, this benchmark should be based on the average over the five previous years. Given the novelty of the introduction of this rule, and its potential effect on some of these institutions, a phasing-in of the rules on the calculation of the level of the pay-out ratio should be provided, where necessary. The introduction of the limits on the payout ratio can be phased-in during the first five years, with a gradual application until end 2017, while the rule should be fully implemented by all institutions in 2018.
- (8) Some non-joint stock companies are not able to issue instruments that are as flexible as common shares in case of an emergency recapitalisation, when institutions are subject to early intervention measures. In those cases, those institutions would need to issue capital instruments to facilitate recovery; therefore, it should be acceptable for those institutions, where the non-voting instruments are usually only held by holders of voting instruments, to exceptionally sell non-voting instruments also to external investors. Further, capital instruments provided for emergency recapitalisation should contain the prospect of an adequate upcoming advantage to be gained after the recovery phase. Therefore, it should be acceptable for those institutions to exceed the limits imposed on the payout ratio after the recovery phase in order to provide that potential upside to the holders of Common Equity Tier 1 instruments provided for the purposes of emergency recapitalisation.
- (9) Under Article 10 of Regulation (EU) No 575/2013, competent authorities may, in accordance with national law, partially or fully waive the application of the requirements set out in parts Two to Eight of that Regulation to credit institutions

affiliated to a central body. In addition, under the same Article, competent authorities may waive the application of Parts Two to Eight of that Regulation to the central body on an individual basis where the liabilities or commitments of the central body are entirely guaranteed by the affiliated institutions. On the basis of that Article, competent authorities should be able to waive the requirements under this Regulation for intragroup capital instruments. Competent authorities should also be able to assess compliance with the requirements set by this Regulation on the basis of the consolidated situation of the institutions that are in the scope of those waivers, notably with regard to the calculation of the payout ratio.

- (10) This Regulation is based on the draft regulatory technical standards submitted by the European Banking Authority to the Commission.
- (11) The European Banking Authority has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010²,
- (12) Commission Delegated Regulation (EU) No 241/2014³ should therefore be amended accordingly.

HAS ADOPTED THIS REGULATION:

Article 1

Delegated Regulation (EU) No 241/2014 is amended as follows:

The following Articles 7a to 7d are inserted:

1. 'Article 7a:

Multiple distributions constituting a disproportionate drag on own funds

1. Distributions on Common Equity Tier 1 instruments referred to in Article 28 of Regulation (EU) No 575/2013 shall be deemed not to constitute a disproportionate drag on capital where all of the following conditions are met:
 - (a) the dividend multiple is a multiple of the distribution paid on the voting instruments and not a predetermined fixed amount;
 - (b) the dividend multiple is set contractually or under the statutes of the institution;
 - (c) the dividend multiple is not revisable;

² Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).

³ Commission Delegated Regulation (EU) No 241/2014 of 7 January 2014 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for Own Funds requirements for institutions (OJ L 74, 14.3.2014, p. 8).

- (d) the same dividend multiple applies to all instruments with a dividend multiple;
- (e) the amount of the distribution on one instrument with a dividend multiple does not represent more than 125% of the amount of the distribution on one voting Common Equity Tier 1 instrument.

In formulaic form this shall be expressed as:

$$l \leq 1.25 \times k$$

where:

k shall represent the amount of the distribution on one instrument without a dividend multiple;

l shall represent the amount of the distribution on one instrument with a dividend multiple;

- (f) the total amount of the distributions paid on all Common Equity Tier 1 instruments during a one year period does not exceed 105% of the amount that would have been paid if instruments with fewer or no voting rights received the same distributions as voting instruments.

In formulaic form this shall be expressed as:

$$kX + lY \leq (1.05) \times k \times (X + Y)$$

where:

k shall represent the amount of the distribution on one instrument without a dividend multiple;

l shall represent the amount of the distribution on one instrument with a dividend multiple;

X shall represent the number of voting instruments;

Y shall represent the number of non-voting instruments.

The formula shall be applied on a one- year basis.

2. Where the condition of point (f) of paragraph 1 is not met, only the amount of the instruments with a dividend multiple that exceeds the threshold defined therein shall be deemed to cause a disproportionate drag on capital.
3. Where any of the conditions of points (a) to (e) of paragraph 1 are not met, all outstanding instruments with a dividend multiple shall be deemed to cause a disproportionate drag on capital.

2. Article 7b:

Preferential distributions regarding preferential rights to payments of distributions

1. For Common Equity Tier 1 instruments referred to in Article 28 of Regulation (EU) No 575/2013, a distribution on a Common Equity Tier 1 instrument shall be deemed to be preferential relative to other Common Equity Tier 1 instruments where there are differentiated levels of distributions, unless the conditions of Article 7a of this Regulation are met.
2. For Common Equity Tier 1 instruments with fewer or no voting rights issued by institutions referred to in Article 27 of Regulation (EU) No 575/2013, where distribution is a multiple of the distribution on the voting instruments and that multiple distribution is set contractually or statutorily, distributions shall be deemed not to be preferential where all of the following conditions are met:
 - (a) the dividend multiple is a multiple of the distribution paid on the voting instruments and not a predetermined fixed amount;
 - (b) the dividend multiple is set contractually or under the statutes of the institution;
 - (c) the dividend multiple is not revisable;
 - (d) the same dividend multiple applies to all instruments with a dividend multiple;
 - (e) the amount of the distribution on one instrument with a dividend multiple does not represent more than 125% of the amount of the distribution on one voting Common Equity Tier 1 instrument.

In formulaic form this shall be expressed as:

$$l \leq 1,25 \times k$$

where:

k shall represent the amount of the distribution on one instrument without a dividend multiple;

l shall represent the amount of the distribution on one instrument with a dividend multiple;

- (f) the total amount of the distributions paid on all Common Equity Tier 1 instruments during a one year period does not exceed 105% of the amount that would have been paid if instruments with fewer or no voting rights received the same distributions as voting instruments.

In formulaic form this shall be expressed as:

$$k \times (1 + \nu) \leq (1,05) \times k \times (x + \nu)$$

where:

k shall represent the amount of the distribution on one instrument without a dividend multiple;

l shall represent the amount of the distribution on one instrument with a dividend multiple;

X shall represent the number of voting instruments;

Y shall represent the number of non-voting instruments;

The formula shall be applied on a one- year basis.

3. Where the condition of paragraph 2 point (f) is not met, only the amount of the instruments with a dividend multiple that exceeds the threshold defined therein shall be disqualified from Common Equity Tier 1.
4. Where any of the conditions of points (a) to (e) of paragraph 2 are not met, all outstanding instruments with a dividend multiple shall be disqualified from Common Equity Tier 1 capital.
5. For the purposes of paragraph 2, where the distributions of Common Equity Tier 1 instruments are expressed, for the voting or the non-voting instruments, with reference to the purchase price at issuance of the instrument, the formulas shall be adapted as follows, for the instrument or instruments that are expressed with reference to the purchase price at issuance:
 - (a) *l* shall represent the amount of the distribution on one instrument without a dividend multiple divided by the purchase price at issuance of that instrument;
 - (b) *k* shall represent the amount of the distribution on one instrument with a dividend multiple divided by the purchase price at issuance of that instrument.
6. For Common Equity Tier 1 instruments with fewer or no voting rights issued by institutions referred to in Article 27 of Regulation (EU) No 575/2013, where the distribution is not a multiple of the distribution on the voting instruments, distributions shall be deemed not to be preferential where either of the conditions referred to in paragraph 7 and both conditions referred to in paragraph 8 are met.
7. For the purposes of paragraph 6, either of the following conditions (a) or (b) shall apply:
 - (a) both of the following points (i) and (ii) are met:
 - (i) the instrument with fewer or no voting rights can only be subscribed and held by the holders of voting instruments;
 - (ii) the number of the voting rights of any single holder is limited;
 - (b) the distributions on the voting instruments issued by the institutions are subject to a cap set out under applicable national law.
8. For the purposes of paragraph 6 both of the following conditions shall apply:

- (a) the institution demonstrates that the average of the distributions on voting instruments during the preceding five years, is low in relation to other comparable instruments;
 - (b) the institution demonstrates that the payout ratio is low, where a payout ratio is calculated in accordance with Article 7c. A payout ratio under 30% shall be deemed to be low.
- 9. For the purposes of point (a) of paragraph 7, the voting rights of any single holder shall be deemed to be limited in the following cases:
 - (a) where each holder only receives one voting right irrespective of the number of voting instruments for any holder;
 - (b) where the number of voting rights is capped irrespective of the number of number of voting instruments held by any holder;
 - (c) where the number of voting instruments any holder may hold is limited under the statutes of the institution or under applicable national law.
- 10. For the purposes of this Article, the one year period shall be deemed to end on the date of the last financial statements of the institution.
- 11. Institutions shall assess compliance with the conditions referred to in paragraphs 7 and 8, and shall inform the competent authority about the result of their assessment, at least in the following situations:
 - (a) every time a decision on the amount of distributions on Common Equity Tier 1 instruments is taken;
 - (b) every time a new class of Common Equity Tier 1 instruments with fewer or no voting rights is issued.
- 12. Where the condition of point (b) of paragraph 8 is not met, only the amount of the non-voting instruments for which distributions exceed the threshold defined therein shall be deemed to entail preferential distributions.
- 13. Where the condition of point (a) of paragraph 8 is not met, the distributions on all outstanding non-voting instruments shall be deemed to be preferential unless they meet the conditions of paragraph 2.
- 14. Where neither of the conditions of paragraph 7 are met, the distributions on all outstanding non-voting instruments shall be deemed to be preferential unless they meet the conditions of paragraph 2.
- 15. The requirement referred to in point (i) of paragraph 7(a), or the requirement referred to in point (b) of paragraph 8, or both requirements may be waived, as appropriate, where both of the following conditions are met:
 - (a) an institution is in breach of or, due inter alia to a rapidly deteriorating financial condition, is likely in the near future to be in breach of any of the requirements of Regulation (EU) No 575/2013;
 - (b) the competent authority has required the institution to urgently increase its Common Equity Tier 1 capital within a specified period and has assessed that the institution is not able to rectify or avoid the breach

referred to in point (a) within that specified period, without resorting to the waiver referred to in this paragraph.

3. Article 7c:

Calculation of the payout ratio for the purposes of point (b) of Article 7b(8)

1. For the purposes of point (b) of Article 7b(8), institutions shall choose either the way described in point (a) or point (b) to calculate the payout ratio. The institution shall follow the way chosen in a consistent manner over time.
 - (a) as the sum of distributions related to total Common Equity Tier 1 instruments over the previous five year periods, divided by the sum of profits related to the previous five year periods;
 - (b) for the period from the date of application of this Regulation until 31 December 2017 only:
 - (i) in 2014, as the sum of distributions related to total Common Equity Tier 1 instruments over the previous one year period, divided by the sum of profits related to the previous one year period;
 - (ii) in 2015, as the sum of distributions related to total Common Equity Tier 1 instruments over the previous two year periods, divided by the sum of profits related to the previous two year periods;
 - (iii) in 2016, as the sum of distributions related to total Common Equity Tier 1 instruments over the previous three year periods, divided by the sum of profits related to the previous three year periods;
 - (iv) in 2017, as the sum of distributions related to total Common Equity Tier 1 instruments over the previous four year periods, divided by the sum of profits related to the previous four year periods.
2. For the purposes of paragraph 1, profits shall mean the amount reported in row 670 of template 2 of Annex III to Commission Delegated Regulation (EU) No 680/2014⁴, or, where applicable, the amount reported in row 670 of template 2 of Annex IV to that Delegated Regulation with regard to supervisory reporting of institutions according to Regulation (EU) No 575/2013.

4. Article 7d:

Preferential distributions regarding the order of distribution payments

For the purposes of Article 28 of Regulation (EU) No 575/2013, a distribution on a Common Equity Tier 1 instrument shall be deemed to be preferential relative to other Common Equity Tier 1 instruments and regarding the order of distribution payments where at least one of the following conditions is met:

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⁴ OJ L 191, 28.6.2014, p. 1.

- (a) distributions are decided at different times;
- (b) distributions are paid at different times;
- (c) there is an obligation on the issuer to pay the distributions on one type of Common Equity Tier 1 instruments before paying the distributions on another type of Common Equity Tier 1 instruments;
- (d) a distribution is paid on some Common Equity Tier 1 instruments but not on others, unless the condition of point (a) of Article 7b(7) is met.'

Article 2

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels, 30.1.2015

For the Commission
The President
Jean-Claude JUNCKER