Consultation response

Draft Addendum to the ECB Guide on options and discretions available in Union law

21 June 2016

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to contribute to the ECB's consultation on its "draft Addendum to the ECB Guide on options and discretions available in Union law".

AFME represents a broad array of European and global participants in the wholesale financial markets. We are contributing to this consultation on behalf of our Special Committee on European Supervision (SCES) which, in its SSM configuration, provides a platform for the most systemically relevant banks who are lead-supervised by the SSM to engage with the ECB's supervisory function and, in its full configuration, is a vehicle for engagement on the future development of supervision within the EU more generally

In particular, we would like to offer our views and recommendations with regard to some areas of the ONDs proposed for harmonisation by the ECB. These are:

- waivers of prudential requirements: maintenance of the solo capital waiver
- 0% risk weight for intra-group exposures
- the exercise of the exemption from cap on inflows (Article 33 (2) Delegated Regulation)
- the governance aspect, i.e. combination of the functions of Chairman of the Management Body and Chief Executive Officer.

1) Waivers of prudential requirements - maintenance of the solo capital waiver

CRR level 1 text: Article 7(1) of the CRR, on the derogation to the application of prudential requirements on an individual basis, does not foresee that the granting of the solo capital waiver should be subject to an assessment of the leverage ratio. The CRR level 1 text is explicit about the conditions under which such waiver can be granted, and these do not include leverage. In our view the legislator did not have the intention to consider leverage when granting a capital waiver, indeed this could not have been the case as the leverage ratio will only apply from 2018. We therefore disagree with the insertion of the additional criteria the ECB is effectively proposing to Article 7(1)[1]

Level playing field: The existence of the same conditions for the granting a capital waiver at solo level is of high importance for maintaining a level playing field among banks. Submitting the granting of a capital waiver to the assessment of the leverage ratio requirement by the ECB would impact only banks of the Banking Union and for the moment only those which are under SSM supervision. Different interpretations within the Single Market will not only raise substantial level playing field issues, but are also against the aim of a single rule book.

[1] "in assessing an application for a capital waiver the ECB will ensure that considerations related to the leverage ratio are taken into account, given that pursuant to Article 6(5) of the CRR granting such waiver will also automatically waive the leverage requirement at the same level of the group structure", Chap 1, point 3 of the consultation

Clarity on the assessment process: The assessment which the ECB indicates it will follow in deciding whether to grant a capital waiver and referred to in point 1 on page 3, Chapter 1 is not clear: it seems to address situations where the controlled entity might incur (in funding) problems and cannot use the liquidity posted with the holding company. In reality we presume that the entity could, also in a stressed scenario close or reduce the intra-group funding if/when needed, whereas the holding group has, at Group level, contingency funding measures in place to deal with a crisis. The issue seems to be not so much at the individual entity level, but rather at Group level, if any.

Legitimate expectations: We welcome the ECB's confirmation during the public hearing of 3 June on the present consultation that waivers granted in compliance with the CRR prior to November 2014 by national competent authorities, and thus is a fully legitimate manner, will continue to exist.

2) 0%risk weight for intra-group exposures

As with the solo capital waiver, a 0% risk weight must continue to apply under Article 113(6) where it has already been granted by national competent authorities.

3) Liquidity: exemption from cap on inflows (Article 33 (2) Delegated Regulation)

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

In our view, combining Articles 33 and 34 of the Delegated Regulation is not entirely equivalent to applying a waiver according to Article 8 of the CRR. This waiver implies being exempted from the LCR minimum requirement from 2018 onward, whereas benefiting from an exemption from the cap on intragroup inflows does not entail being exempted from a minimum LCR level.

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

For practical purposes, it would also be advisable to specify whether the documentation requested for the Article 8 CRR waiver is to be presented for the exemption on the cap inflows too.

Indeed, the application process raises a number of questions on which we would welcome clarity. Will there be a cap exemption application or should firms apply via discussions with their JST? And are firms required to await decisions being made on Article 8 waiver applications before making applications under article 33(2) and 34? Does the ECB intend to allow firms which have not applied for an Article 8 waiver the opportunity to apply for Article (33(2) and 34 waivers, or does the ECB intend only to grant Article 33(2) and 34 waivers if and only if the firm has applied for an Article 8 waiver but has failed (or is likely to fail) to obtain that an Article 8 waiver?

More clarity on specific provisions would also prevent inconsistencies –

- 14 (2) (ii) There are no provisions that would allow the intragroup counterparty providing the inflows to withdraw from its contractual obligations or impose additional conditions. Clarity is needed that "provisions" do not mean provisions in company or other law that could allow an intragroup counterparty to withdraw from its contractual agreements.
- 14 (2) iii. The terms of the contractual agreement giving rise to the inflows cannot be changed substantially without the prior approval of the ECB. What is meant by 'substantially'? Are 'business as usual' transactions, such as renewals of lines, exempt from this requirement? It would help if the ECB could define a list of 'relevant transactions' which would require ECB approval?
- 14 (2) (vii) "…a sound liquidity position could be considered to exist if the liquidity management of both institutions as evaluated in the SREP is deemed to be of high quality." The reference to "both institutions" needs further explaining since they need not both be institutions.

One specific paragraph would benefit from an amended text: 14(2) (v) The applicant entity is able to demonstrate that the inflows are also properly captured in the contingency funding plan of the intragroup counterparty. This should be changed into:

v) The applicant entity is able to demonstrate that the inflows are also properly captured in the contingency funding plan of the intragroup counterparty. *If the intragroup counterparty is the parent entity then the Group/Parent contingency funding plan should apply.*

Not all potential intragroup counterparties are required to produce contingency funding plans. Therefore if either party is the group's ultimate parent entity, it should be possible to utilise the group contingency funding plan to satisfy this criterion.

4) Governance: combination of the functions of Chairman of the Management Body and Chief Executive Officer (article 88.1.e of CRD IV)

In its consultation document, the ECB states at the start of point 9.3 that it "considers that the separation of the executive and non-executive functions is the rule for credit institutions". This statement is not in line with article 88.1.e of CRD IV and exceeds the scope of the CRD, for the reasons set out below.

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

This rule does not imply that the chairman of an institution should not have executive powers, but establishes the prohibition to exercise the functions of the Chairman and CEO by the same person, with the aim of avoiding the concentration of power in a single person.

This is also be the case of the Guidelines of the Basel Committee on Banking Supervision setting the Corporate Governance principles for banks (July 2015) mentioned by the ECB in the consultation paper. Paragraph 62 of these Guidelines acknowledge that "In jurisdictions where the chair is permitted to assume executive duties, the bank should have measures in place to mitigate any adverse impact on the bank's checks and balances, e.g. by designating a lead board member, a senior independent board member or a similar position and having a larger number of non-executives on the board." Consequently, these Guidelines recognise cases where the role of an executive chairman is appropriate.

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

In short, the current regulatory framework recommends splitting the roles of chairman and CEO, but does not limit the possibility to have an executive chairman.

The ECB's approach is more restrictive than the provisions mentioned above, as it states there is a *need* to separate the "executive and non-executive functions".

Secondly, the ECB Guide on options and discretions available in Union Law should establish the procedures for the granting of the authorisation for the combination of functions of the Chairman and CEO, following the CRD IV's empowerment. As such in our view, it should not contain such a prescriptive statement as the starting paragraphs of this point 9.3.

Considering the above, we suggest the following amendments to point 9.3:

~~"The ECB considers that the separation of the executive and non-executive functions is the rule for credit institutions. Sound principles of corporate governance require that both functions be exercised in line with their responsibilities and accountability requirements.~~

~~The responsibilities and accountability requirements of the chairman of the management body in its supervisory function (Chair) and the chief executive officer (CEO) diverge, reflecting the different purposes of each supervisory function and management function respectively.~~

~~Moreover, the~~ The Corporate Governance principles for banks (Guidelines) of the Basel Committee on Banking Supervision (July 2015) recommend that in order "to promote checks and balances, the chair of the board should be an independent or non-executive board member. In jurisdictions where the chair is permitted to assume executive duties, the bank should have measures in place to mitigate any adverse impact on the bank's checks and balances, eg by designating a lead board member, a senior independent board member or a similar position and having a larger number of non-executives on the board." (paragraph 62).

The authorisation to combine the ~~two~~ functions of the chairman of the management body in its supervisory function and of a chief executive officer ~~of~~ should, therefore, be granted only in exceptional cases and only where corrective measures are in place to ensure that the responsibilities and accountability obligations of both functions are not compromised by their being combined.

The ECB intends to assess applications for the combination of the two functions in line with the above- mentioned Basel principles and the European Banking Authority's Guidelines on Internal Governance (GL 44), where it is recommended that ~~in the case of combination of the two functions,~~ where the chair of the management body is also the chief executive officer of the institution, the institution should have measures in place to minimise the potential detriment on its checks and balances".

[redacted]

About AFME

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. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

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