CRD IV capital buffers

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I. CRD Capital buffer

What is the capital buffer and what is it desired effect?

- CRD terminology: combined buffer requirement
- Buffer provisions are not strict requirements
- Buffer aims to be a breathing space between a healthy capital level and hard intervention levels
  - Buffer prevents build up of macro-economic imbalances
  - Buffer limits the possible spill-overs on the system from the (imminent) bankruptcy of large institutions
  - Buffer aims to limit the ex-ante risk of too-big-too fail / save

-> How do we determine the size of the buffer?

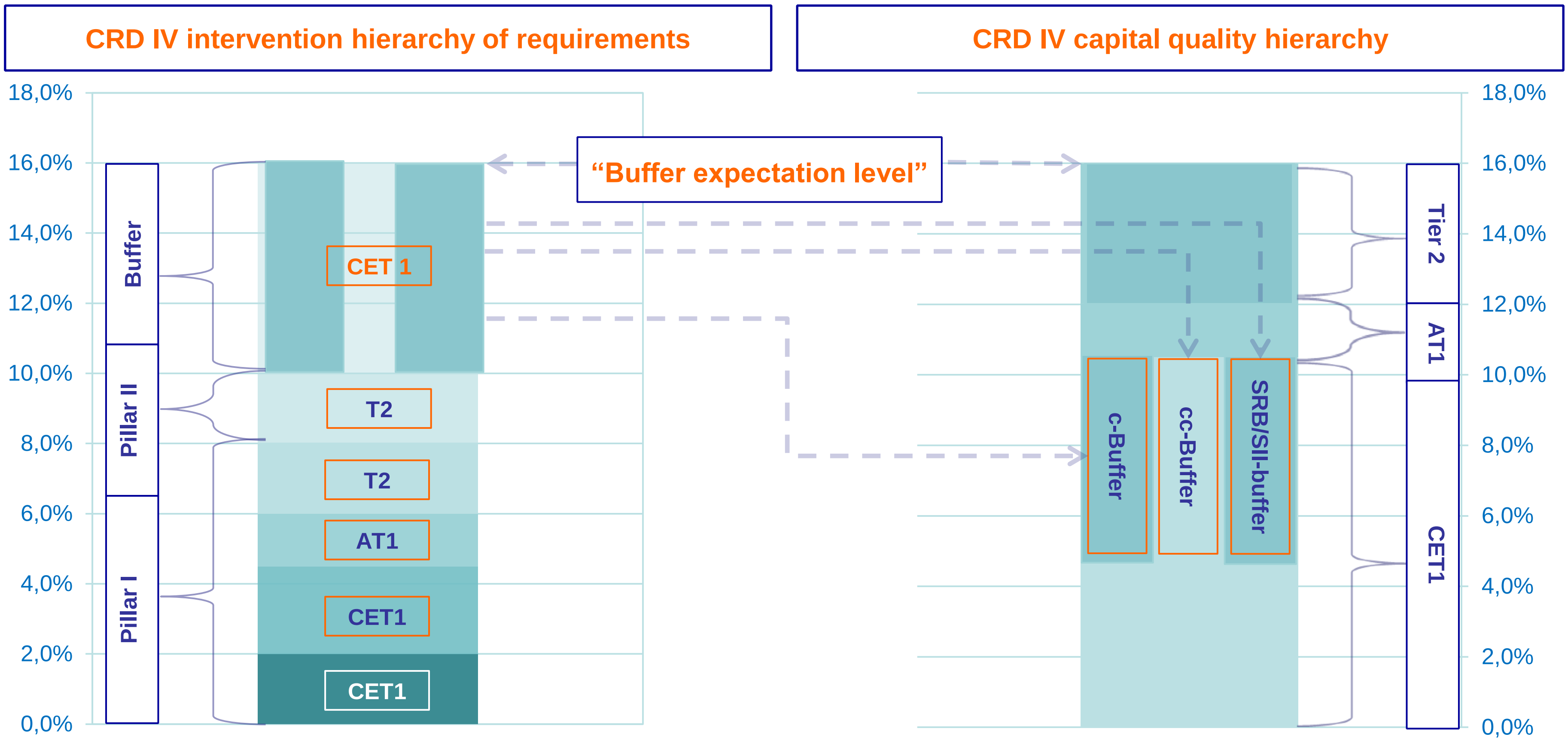
II. Buffer – composition

How do we determine the buffer expectation level?

- CRD IV includes three buffer components:
  - c-buffer: conservation buffer (2,5%)
  - cc-buffer: countercyclical buffer (0-2,5%)
  - SRB/G-SII/O-SII buffer (0-3%)
    - The SRB may be imposed on one or more subsets of the financial sector
    - The G-SII or O-SII are what we commonly refer to as “SIB”
    - SRB, G-SII, O-SII are *highest of or additive* depending on situation
  - cc-buffer and SRB can be set higher under strict conditions

-> What is the expected size of the buffer?

III. Buffer to capital requirements



All examples assume 2% Pillar II SREP add-on imposed by supervisor and 6% total buffer for all three buffer components. In this example the TIer1, Own Funds and Pillar II requirements are met with the lowest possible capital quality.

IV. Buffer - capital

Which capital is available to meet the buffer expectation?

- Reminder: buffer is one indistinguishable buffer
- Buffer must be met by CET1 capital
- Pillar II demands have to be satisfied first
- Solo and consolidated application
- Also at holding level depending on situation

V. Calculate conservation buffer

How do we determine the capital conservation buffer?

- The capital conservation buffer applies to all banks
- Cc-buffer always equals 2,5% of the TREA

VI. Determination of SRB / SII-buffer

How do we determine the SRB / SII buffer?

- SRB buffer is implemented with national specifications
- Expect for this moment only a buffer on SIB’s
  - Level determined by DNB
  - Legally based on both SRB and O-SII
  - CRD = FSB criteria
    - Interconnectedness, scale, complexity, irreplaceability, cross-border,
    - Methodology for SII to be set out by the EBA
    - Systemically important institutions may including holding companies

VII. Calculation of CCB (1)

How does a bank calculate the countercyclical buffer?

- Country percentage x% * relevant credit exposures
  - x% determined by local authorities
  - ESRB will advice on x% for non-EEA members
  - x% is between 0-2,5%
- Sum over all exposures and all countries

VIII. Buffer - consequences

What if a bank does not meet the buffer expectation?

- Calculate and report the maximum distributable amount
- Insufficient buffer limits payments on:
  - dividend on CET 1 instruments
  - bonuses
  - Payments on Additional T1 instruments
- Capital conservation plan
  a) estimates of income and expenditure and a forecast balance sheet
  b) measures to increase the capital ratios of the institution
  c) a plan and timeframe for the increase of own funds to meet the combined buffer requirement
  d) any other information the competent authority deems necessary

IX. Restricted payments

What is the restricted level of payments ?

- Nominal limit to pay-out profits (0 profit = 0 payments)
- Start off maximum distributable amount
  - *MDA is a percentage of profits*
  - *MDA % is based on a table*
    - *Step 1: determine available CET1*
    - *Step 2: deduct CET1 needed to meet PI and PII requirements*
    - *Step 3: determine combined buffer requirement*
    - *Step 4: asses remaining CET1 against combined buffer requirement*
    - *Step 5: determine MDA% in table*
    - *Step 6: multiply profits with MDA%*

X. Restricted payments table

Where can I find the MDA percentage?

Available CET1 buffer above PII	MDA%
75-100%	60%
50-75%	40%
25-50%	20%
0-25%	0%

XI. Buffer – transitioning

At what rate does the buffer apply during transitioning?

- Starts as of January 1st 2016
- Maximum buffer per year
- Applies through December 31ste of reporting year

	2015	2016	2017	2018	2019
c-buffer	0	0.625	1.25	1.875	2.5
cc-buffer (max)	0	0.625	1.25	1.875	2.5
SRB-buffer (max)	0	0.75	1.5	2.25	3
buffer (max)	0	2	4	6	8

XII. Buffer – example (1/7)

Balans MegaBank ultimo 2017

Exposures	Type	TREA-credit risk	% Totaal TREA
Nederland	mortgages	€10.000.000.000	31,25%
Nederland	sovereign	€4.000.000.000	12,50%
Duitsland	retail	€5.000.000.000	15,62%
UK	institutions	€3.000.000.000	9,375%
UK	securitisations	€5.000.000.000	15,62%
US	credit cards	€2.500.000.000	7,813%
Kenya	corporates	€2.500.000.000	7,813%
Totaal		**€32.000.000.000**	**100%**

XII. Buffer – example (2/7)

Relevant credit exposures MegaBank ultimo 2017

Exposures	**Type**	**TREA-credit risk**	**% Totaal**
Nederland	mortgages	€10.000.000.000	40%
~~Nederland~~	~~sovereign~~	~~€4.000.000.000~~	
Duitsland	retail	€5.000.000.000	20%
~~UK~~	~~institutions~~	~~€3.000.000.000~~	
UK	securitisations	€5.000.000.000	20%
US	credit cards	€2.500.000.000	10%
Kenya	corporates	€2.500.000.000	10%
Totaal		**€25.000.000.000**	**100%**

XII. Buffer – example (3/7)

Applicable countercyclical buffer rates

Exposures	Authority	Country-rate
Nederland	DNB	1%
Duitsland	BaFin	1%
UK	PRA	0%
US	DNB + (ESRB)* + BCBS	1,5%
Kenya	DNB + (ESRB)*	2%

XII. Buffer – example (4/7)

“Institution specific” countercyclical buffer rate

Exposures	% Totaal	Country-rate	Multiplied
Nederland	40%	1%	0,40%
Duitsland	20%	1%	0,20%
UK	20%	0%	0,00%
US	10%	1,5%	0,15%
Kenya	10%	2%	0,20%
Totaal	**100%**		0,95%

XII. Buffer – example (5/7)

Megabank total buffer:

- 2,5% (c-buffer)
- 0,95% (cc-buffer)
- 2% (SII-buffer), DNB considers Megabank a SIFI

= 5,45%

XII. Buffer – example (6/7)

MegaBank has:

- 9,5% CET1 capital (instruments – deductions)
- 2% AT1 capital
- 0% T2 capital

Hence there is 3,5% CET1 capital available for buffers

- 4,5% of CET1 used for CET1 requirement
- 1,5% of AT1 used for Tier 1 requirement
- 0,5% of AT1 used for TC requirement
- 1,5% of CET1 used for TC requirement

XII. Buffer – example (7/7)

- MegaBank meets buffers for 64% (i.e. 3,5%/5,45%)
- Hence: MDA% = 40% (see table before)
- Assume MegaBank made a profit of €500 mln
- Hence MegaBank may use €200 mln for paying out
  - Dividend
  - Bonuses
  - Payments on AT1 instruments
  - Buy-back shares

Leverage ratio (LR)

Requirements on leverage

- *Pillar I:* *Not yet.*
- *Pillar II:* *identification, monitoring and management*
- *Pillar III:* *disclosure requirement.*
- *Reporting:* *yes.*

Pillar III - calculation of leverage ratio

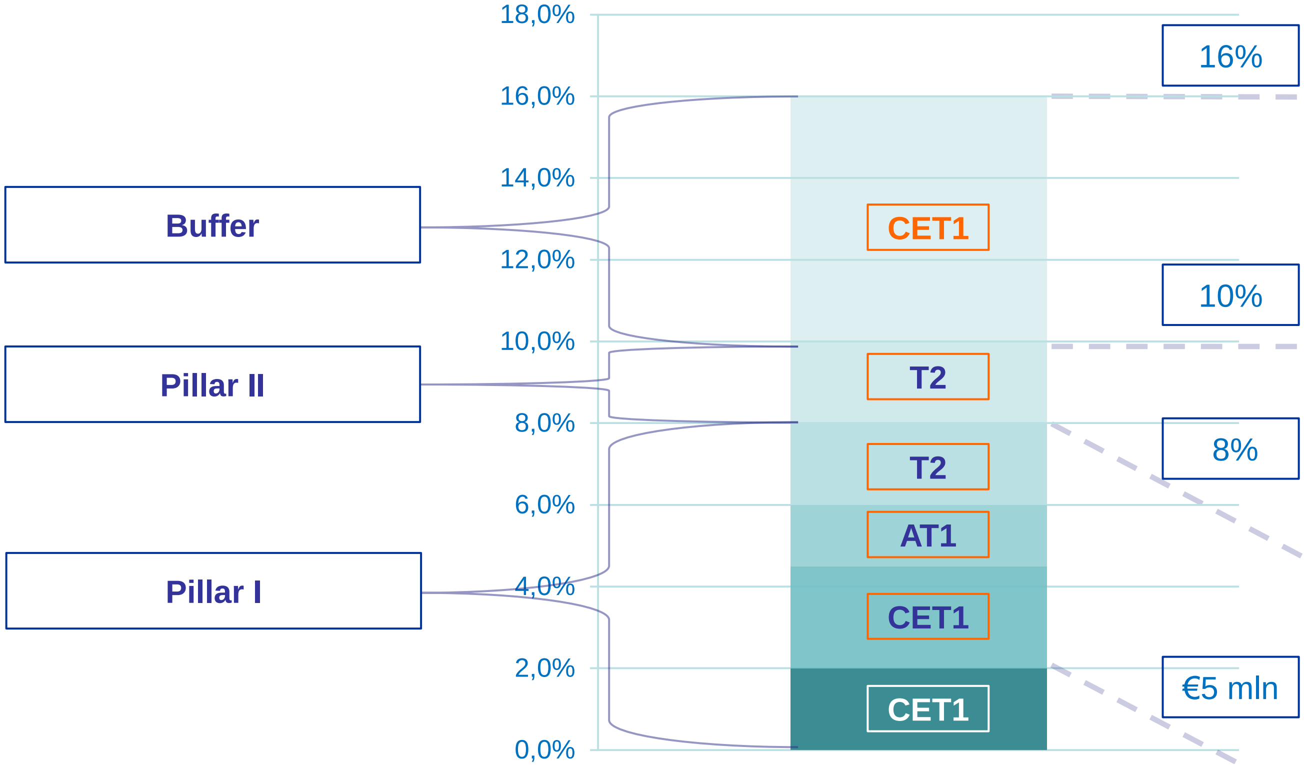
An institution's capital measure divided by total exposure measure.

$$Leverage\ ratio = \frac{Tier1\ capital}{Total\ exposure\ amount}$$

- Arithmetic mean of monthly leverage ratios over a quarter.
- Capital measure consists only of Tier1 capital as defined in CRR.25.
- Total exposure amount is roughly equal to exposure values after CCF under the standardised approach, including the SA for provisioning

CRD IV interventions

I. Capital intervention ladder



Buffer regime applies:
- Capital conservation plan.
- Restrictions on dividend, bonuses, etc. by MDA.

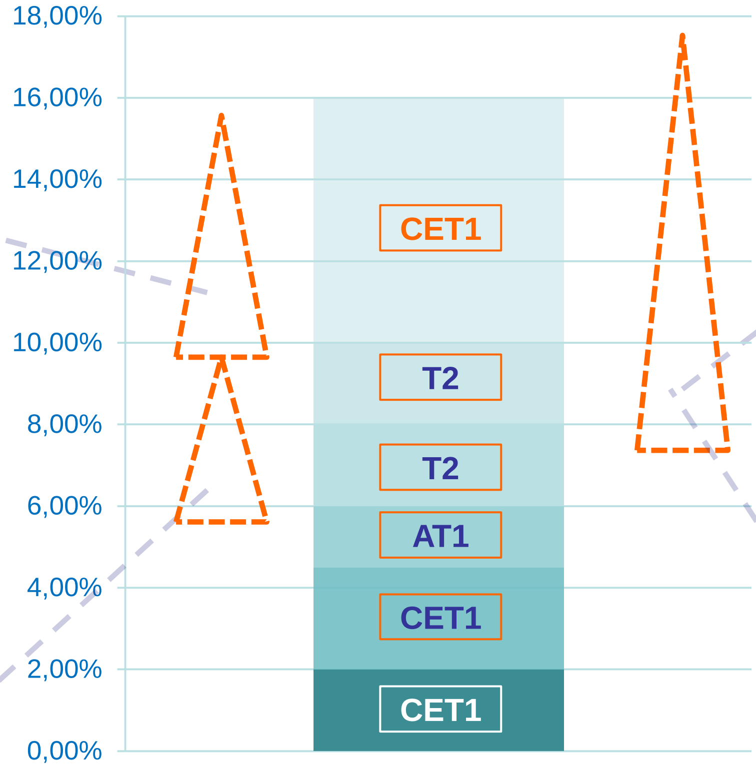
Breach of Pillar II requirement
Possible withdrawal of authorisation.

Breach of Pillar I requirement
Imminent withdrawal of authorisation.

Breach of Initial own funds requirement:
Immediate withdrawal of authorisation.

II. Capital intervention powers

Breach of buffer expectation level
Normal supervisory powers are aimed at enforcing the capital conservation plan and preventing distributions above MDA, but not at maintaining the buffer as a requirement as such.



Normal supervisory powers (CRD.104), e.g.:
- Capital add-on.
- Specific provisioning.
- Reduce inherent risk.
- Restrict business.
- Block dividend.
- Additional reporting.
- Additional disclosures.

Breach Pillar I or Pillar II
If Pillar II requirement is breached, supervisor may withdraw authorisation.
If Pillar I requirement is breached, supervisor will withdraw authorisation.

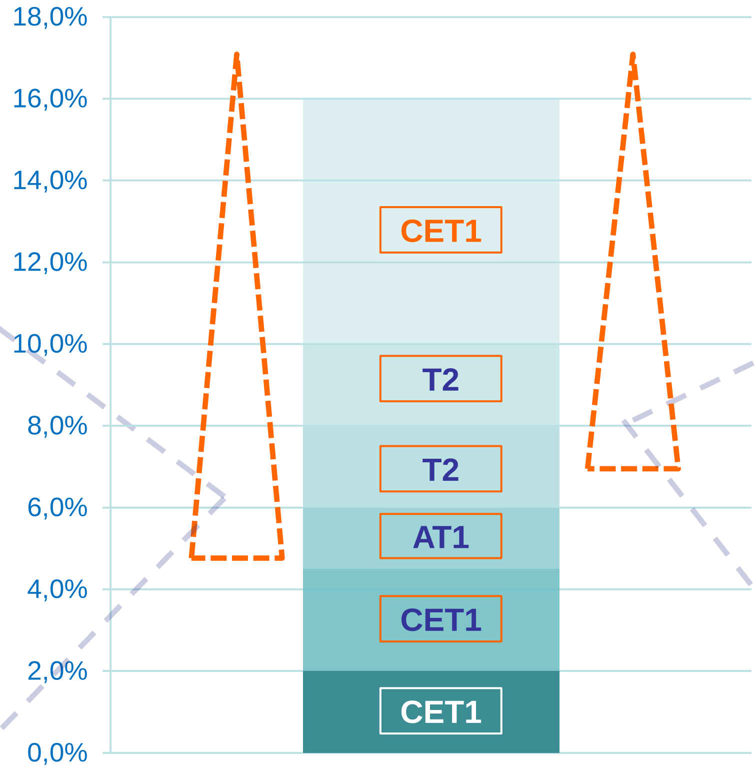
Presented triggers assume satisfying Total capital and Pillar II requirements with low quality capital

Point of non-viability:
(PON-V) is assessed on CET 1 ratio at 5,125%.
Supervisor will trigger AT1 instruments conversion into CET1.
In this example triggered at 10,625% TC-ratio.

III. Intervention powers

"Special" supervisory powers (CRD.66+67), e.g.:
- Publication statement
- Cease and desist order
- Authorisation withdrawal
- Ban management
- Pecuniary penalty on the institution of 10% total annual net turnover
- Pecuniary penalty on natural persons of 5 mln
- Pecuniary penalty of up to twice the amount gained by the breach

Additional powers under Dutch law e.g.:
- Appoint custodian (Wft 1:76 + Wft 3:159d).
- Transfer plan (Wft 3:159c).
- Winding-up procedure (Wft 3:160).



"Normal" supervisory powers (CRD.104), e.g.:
- Capital add-on.
- Specific provisioning.
- Reduce inherent risk.
- Restrict business.
- Block dividend.
- Additional reporting.
- Additional disclosures.

"General" supervisory powers, e.g.:
- Administrative penalties (CRD.65.1)
- Incremental administrative penalties (CRD.65.1)

IV. CRD IV sanctions

What changes under CRD IV regarding sanctions?

- CRD IV includes a minimum list of sanctions
- Art 64-72 CRD
  - Public statement on sanctioning
  - Cease and desist order
  - Revoke authorisation
  - Ban members of the Board RvB/RvC
  - Administrative sanction up to twice the gain from the breach
  - Cancel voting rights of particular share holders
  - Increase maximum sanction up to 10% of yearly turnover

V. Sanctions

When does the 10% turn-over fine apply?

- Art 66 & 67 CRD include a list, e.g.:
  - Failing to comply with any main provision
  - Failing to submit adequate information concerning:
    - Pillar I, II & III, e.g..: capital requirements, liquidity, large exposures, leverage ratio, retention, disclosure
  - Inadequate governance
  - Payments in violation of the maximum distributable amount
  - Attract deposits without authorisation
  - Obtain a qualified holding
  - Violation of anti money laundry (AMLD)