PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers
Enterprise Advisory
Woluwe Garden
Woluwedal 18
B-1932 Sint-Stevens-Woluwe
Telephone +32 (0)2 710 4211
Facsimile +32 (0)2 710 4299
www.pwc.com

Mr Patrick Pearson
Head of Banking & Financial Conglomerates Unit (H1)
European Commission
Directorate General Internal Market and Services (04/20)
Rue de Spa, 2
B – 1000 Brussels

12 June 2008

Dear Patrick

Feedback to the European Commission on potential changes to the Capital Requirements Directive "CRD", consisting of Directives 2006/48/EC and 2006/49/EC

PricewaterhouseCoopers welcomes the opportunity to provide feedback on the consultation paper setting out the proposed changes to the CRD.

Overall comments

We have comments on specific areas of the consultation paper that we set out below. However, we would like to make some introductory remarks before looking at the detail, in order to reflect the recently published concerns over the adequacy of the new CRD capital regime in the recent market turmoil.

First, as advisers to a wide range of firms we consider that the implementation of the CRD, and particularly the Pillar 2 framework, has already proved to be valuable by focusing both firms and regulators on the proper management of risk. It has also assisted other stakeholders, such as participants in some of the restructurings made necessary by the Credit Crunch / market dislocation, to get a fuller picture of the position of troubled market participants and the risks perceived by their senior management. As a result, the CRD is demonstrating itself to be a useful tool through which market stability can be increased. When the disclosures required by Pillar 3 start to be made, we believe that transparency will also be improved significantly. Refinements are needed, and the proposals are a step in that direction. We look forward to the revisions to the CRD, and to the full implementation of Pillar 3, to move this critical improvement process forward.

Secondly, in the debates over both the Credit Crunch / market dislocation and the tools that should be used to minimise the risk of it happening again, it is important not to forget that banks are a key part of the "real" economy, through the provision of cost effective finance to commerce and

industry. The current desire to build a "post Credit Crunch" capital regime that will lead to a more stable financial sector should not, without careful thought, exacerbate deleveraging and increase the cost of finance to industry by limiting the use of particular financing tools such as securitisation. In addition, the desire to mitigate the risks of contagion in the financial markets by limiting inter-bank exposures should be cognisant of the implications of such restrictions for the provision of liquidity to the market when needed. In summary, appropriate, risk-based capital requirements for firms are fundamental, but they should be developed with reference also to the wider economic impacts.

Finally, several of the areas where proposals for change are made in the consultation paper, for example inter-bank lending under one year and securitisation, are areas where banks need to make subjective judgements in their risk processes. We suggest that the simple Pillar 1 approach may not deal adequately with such subjectivity. It needs instead, proper use of Pillar 2 and informed supervisory reviews by experienced supervisors.

Large exposures

Article 4 paragraph 45 – definition of 'group of connected clients'

The proposed amendment appears to extend the potential for entities to be considered a group of connected clients where one entity experiencing "funding or repayment difficulties" would mean other entity(s) would be likely to encounter funding or repayment difficulties.

We note that the CEBS advice states that "institutions should work to identify exposures or liabilities to counterparties that represent one idiosyncratic risk to such a degree that they constitute a single risk".

The practical implication of how this will be implemented by supervisory authorities and how firms will be expected to comply with this provision is unclear.

Further clarification is needed on what will be required of firms in order for them to assess whether "idiosyncratic risk" exists between counterparties. For example, the proposals leave open the issue of whether macroeconomic factors should be considered or whether the assessment should be restricted to the specific funding arrangements in place between particular counterparties.

Article 110 paragraph 1 – reporting large exposures gross

The proposed amendment will require firms to report the exposure value of large exposures before taking into consideration the effect of credit risk mitigation. We have seen cases where gross exposures that are highly material to the firm would not be disclosed to supervisors if shown net. We note that CEBS made reference to the practical issues this proposal may cause for firms which have exposures to derivative instruments and securities financing transactions.

We would reinforce CEBS's comments by adding that reporting exposures gross is likely to present even more practical issues for firms that apply the Internal Model Method to calculating counterparty credit risk exposures or the Internal Rating Based approach for non-trading book exposures. A more appropriate tool to address supervisory concerns on the reliance of collateral and other forms of credit risk mitigation may be via Pillar 2 and through more considered supervision of the potential systemic and liquidity risks of large collateral pools.

Article 111 paragraph 1(i) and Article 113 – inter-bank exposures

The amendment to Article 113(i) is proposing to remove the current exemption for large exposure purposes of exposures to institutions with a maturity of one year or less. We note from the CEBS paper that this proposal was not unanimously agreed by all CEBS members on the basis that it is not the appropriate time to propose a change in the regulatory regime of interbank exposures mainly due to the time constraints of carrying out a full quantitative assessment of the associated costs.

We would reinforce the importance of fully assessing the quantitative impact of the proposal taking into account the potential impact on firms' and group's liquidity management and ability to hedge their other exposures.

Article 113(1)(f) – intra-group exposures

The proposed amendment removes the current Member State discretion on full or partial exemption of intra-group exposures and requires Member States to exempt in full all intra-group exposures that meet certain conditions.

Although this proposed amendment appears to remove a significant Member State discretion, the interpretation and implementation of the requirement may differ significantly across Member States due to the relative subjectivity of the criteria in Article 80(7) of Directive 2006/48/EC. Areas of potential divergence among Member States may arise when assessing equivalent prudential standards for third-country groups and the transferability of capital between group entities in different jurisdictions.

In any event, divergence across Member States in respect of permitted intra-group funding arrangements already exists by virtue of the discretion Member States have under Article 69 of Directive 2006/48/EC to waive capital requirements on a solo basis if certain conditions are met. For the Member States that rely on this discretion to waive solo requirements, the proposed amendments to Article 113(1)(f) are irrelevant.

Further work is needed to assess the extent to which Member States rely on the Article 69 discretion and, if relevant, how they will implement the proposed amendment to Article 113 in

practice to assess the extent to which material divergences exist, or will exist, on permitted intra-group funding arrangements.

Hybrid Capital Instruments

The implementation of the proposed changes in the definition of capital ahead of the impending review of capital definition by the Basel Committee of Banking Supervision could cause institutions to have to adapt twice to a new regulatory framework within a relatively short timeframe thus creating uncertainty and potential costs for firms. In addition, the actual impact for firms of the proposed changes will be dependent to a large extent on national tax, accounting, company and insolvency regimes and may even lead to creating an unlevel playing field across Europe as a result.

We would also question what the impact of the proposed changes will be for Pillar 2 i.e. the extent to which the proposed definition of own funds will be viewed by both firms and Member State regulators as being eligible to meet Pillar 2 requirements.

It is unclear from the proposed amendments what the treatment of perpetual non-cumulative preference share capital is intended to be. We understand that currently a number of Member State jurisdictions allow non-cumulative perpetual preference shares as tier 1 capital by virtue of Article 57(a). This is on the basis that such instruments are classified as equity capital.

The CEBS advice refers to “hybrids” as including non-cumulative perpetual preference shares. The implication therefore is that non-cumulative perpetual preference shares are limited along with other forms of “hybrid” capital to 50% of tier 1. Requiring that at least 50% of tier 1 consists of ordinary share capital and retained earnings is consistent with the Sydney Press Release. However, the proposed amendments to Articles 57 and 66 of Directive 2006/48/EC do not make the position clear.

Technical changes

Article 95 – Securitisation

The proposed amendment requires originators of securitisations where significant risk has been transferred to third parties to retain no less than 15% of the risk-weighted exposure amounts of the securitised exposures.

The securitisation market is a key market for institutions wanting to raise funding and diversify their funding sources. Securitisation allows institutions to transfer risk and mitigate their geographical and/or sectoral concentrations. In addition, securitisation plays a key role in allowing banks to sustain a given level of credit supply and therefore supporting economic growth.

The introduction of the 15% charge may increase the cost of raising external funding through securitising assets. More importantly, the proposed 15% charge may not be consistent with the economic risks associated with such funding structures. Therefore, there is a risk that the proposed regulatory charge is inconsistent with the principles of a risk-based capital regime and the efficient management of economic capital.

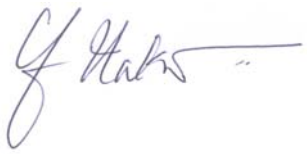
We would recommend that a more appropriate and risk-based approach would be to develop qualitative requirements that apply to the internal processes of the originator. In addition, enhanced disclosure in both statutory accounting and under Pillar 3 will help to mitigate the general lack of transparency around institutions' exposures to securitisation that has materially contributed to the recent market events.

Annex IX, Part 2 – material risk transfer

Paragraph 10 of Annex IV, Part 2 introduces a new requirement for considering when credit risk has been transferred where there are no mezzanine tranches in the securitisation. The rationale behind this proposed requirement is unclear bearing in mind that firms already have to risk-weight at 1250% or deduct from capital first loss/expected loss positions.

We would be pleased to discuss our comments should you have any queries.

Yours sincerely



Charles Ilako
Lead Partner
Global Financial Services Regulatory Practice
PricewaterhouseCoopers