EBA EUROPEAN BANKING AUTHORITY

Public hearing:
Revision of the RTS on own funds and eligible liabilities

24 June 2020 | Virtual meeting

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1 - MANDATES AND SCOPE

1. Mandates and scope

No new RTS mandates for the area of own funds

Changes introduced with CRR2 necessitate revision of existing RTS provisions to reflect the Level 1 text

For eligible liabilities, the EBA is mandated to specify further a number of aspects:

1. The applicable forms and nature of direct and indirect funding of eligible liabilities instruments
2. The form and nature of incentives to redeem
3. The permission regime for eligible liabilities, in particular on the following aspects:
   a) the procedure, including the time limits and information requirements;
   b) the meaning of 'sustainable for the income capacity of the institution';
   c) the process of cooperation between the competent authority and the resolution authority;

1. Mandates and scope

RTS mandates in the area of eligible liabilities – requirement of full alignment with own funds' regime

The CRR requires the EBA RTS regarding indirect funding, incentives to redeem and the meaning of "sustainable for the income capacity" to be **"fully aligned"** with the RTS on own funds.

More generally, it is important to ensure a level playing field across instruments that share similar loss absorbency features, especially to avoid discriminating banks meeting MREL with own funds only and those meeting MREL also with debt.

Scope of RTS in relation to eligible liabilities

The CRR eligibility criteria and permission regime apply to TLAC and internal TLAC eligible liabilities, both subordinated and non-subordinated.

From the implementation date of BRRD2 (i.e. end 2020), the CRR eligibility criteria and permission regime will also apply to MREL and internal MREL eligible liabilities, both subordinated and non-subordinated.

The RTS specifications will apply to this broad scope, meaning, they will equally apply to eligible liabilities for internal TLAC and internal MREL purposes.

2 - REVISION AND AMENDMENT OF RTS ON OWN FUNDS

2. Update of the own funds framework

- CRR2 introduced modified terminology to a number of articles setting out the own funds framework -> RTS provisions are amended to reflect this change in Level 1 text terminology
- Permission regime for reducing capital in Article 77-78 CRR is amended significantly, including introduction of general prior permission -> RTS changed to reflect this accordingly
- Codification of supervisory practices
- Other amendments are of technical nature (e.g. changing references)

All in all, the draft CP puts forward proposals for changes and amendments of 13 RTS provisions:

- Article 4 (Type of undertaking recognised as cooperative society under national law),
- Articles 8 and 9 (Indirect funding),
- Article 20 (Incentives to redeem),
- Articles 25 and 26 (Indirect holdings arising from index holdings),
- Articles 27, 28, 29, 30, 31 – and introduction of new Article 30a (Permission regime),
- Article 32 (Redemption of CET1 instruments by mutual, cooperative societies and similar institutions),
- Article 33 (Temporary waiver from deduction due to financial assistance operation)

2. Extension of the RTS to eligible liabilities (1)

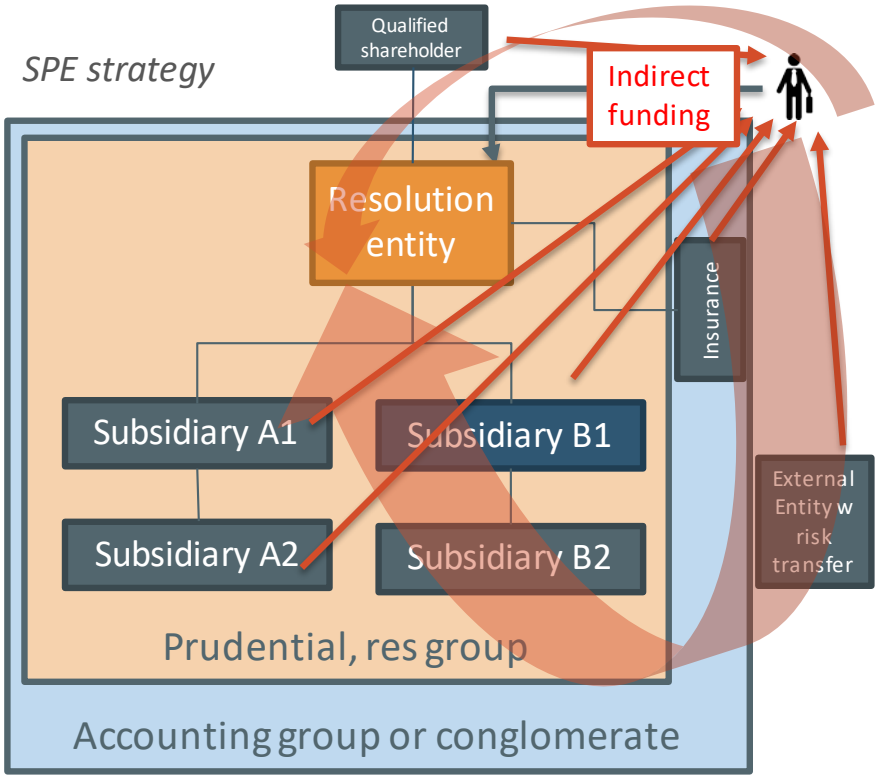
a) Direct and indirect funding (SPE)

CRR provisions on own funds aim to ensure that institutions issue actual loss absorbing capacity rather than instruments which, directly or indirectly, eventually expose them to their own losses.

This is illustrated by the rules on placement: OFs must not be owned by the institution itself, nor a subsidiary or undertaking in which it has >20% of voting rights.

Restrictions on direct and indirect funding go one step further: they aim to avoid a situation where, even though the instrument is placed with another entity, it is in fact funded by the institution itself or by another entity of its group in a way that would eventually feed losses back to the issuing institution.

The same prohibition is set out for TLAC and MREL (but is addressed to resolution entity or entity subject to internal MREL where applicable). The RTS fully aligns these cases.



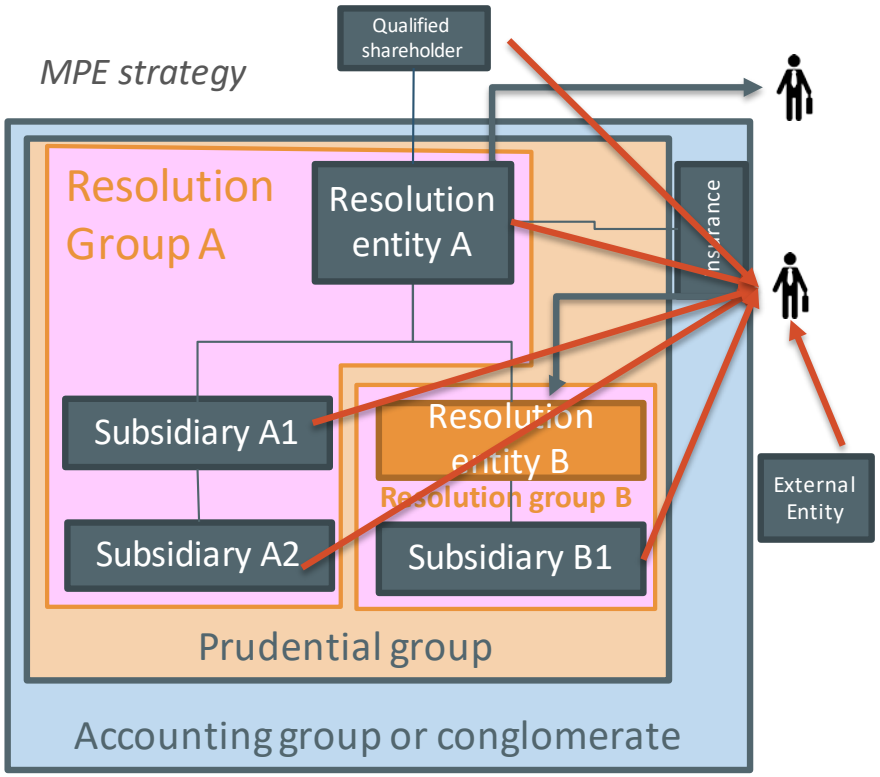
2. Extension of the RTS to eligible liabilities (2)

b) Direct and indirect funding (MPE)

MPE groups: the CRR allows for a parent resolution entity to purchase the EL of a subsidiary resolution entity. However, the current interpretation of rules would not allow for the parent to indirectly fund the EL of the subsidiary via a third party entity.

While it is acknowledged that there is an asymmetry between purchase and funding, the text remains fully aligned, as required by the CRR, for the following main reasons:

- The same asymmetry also exists for own funds
- The RTS should not create unlevelled playing field between own funds and ELs, and between banks meeting MREL with OFs only and others



2. Extension of the RTS to eligible liabilities (3)

b) Incentives to redeem

- Article 20 of the RTS sets out a non-exhaustive list of what incentives to redeem can be
- Incentives to redeem run contrary to the logic of permanence/stable loss absorbing capacity -> forbidden for own funds
- For eligible liabilities, the consequence is less stringent: the instrument won't be invalidated but its maturity is shortened to the date at which a redemption option is exercisable. However, the logic is the same and this is why, the provisions are fully aligned

c) Notion of sustainable replacement terms as a condition for authorisation to redeem

- This is a prudential safeguard set out by the CRR to ensure that a replacement is not done at the expense of the viability of the institution.
- The criterion is now equally applicable to eligible liabilities, as CRR requires full alignment with own funds

2. Permission regime for reducing capital and eligible liabilities – types of permissions

Own Funds: I - Replacement (Art. 78(1)(a) CRR)	II - Reduction (Art. 78(1)(b) CRR)	III – Reduction of OFs during first 5 yrs from issuance (Art. 78(4) CRR)
Permission to replace OFs or related share premium accounts: • with OFs of **equal or higher quality** • **Before** or **at the same time** • at terms that are **sustainable for the institution's income capacity**	Permission to reduce OFs or related share premium accounts: • Bank to demonstrate that it meets **OFs and MREL requirements** • By a **margin** that the **CA considers necessary**	Permission to reduce AT1, Tier 2 or related share premium during the first 5 years from date of issue • Change in regulatory classification • Change in tax treatment • Grandfathered instruments • Replacement at sustainable terms and justified by exceptional circumstances • For market-making purposes

Eligible Liabilities: I - Replacement (Art. 78a(1)(a) CRR)	II - Reduction (Art. 78a(1)(b) CRR)	III - Replacement necessary to comply with OFs (Art. 78a(1)(c) CRR)
Permission to replace ELs prior to their contractual maturity • with other ELs or OFs of **equal or higher quality** • **Before or at the same time** • at terms that are **sustainable for the institution's income capacity**	Permission to reduce ELs prior to their contractual maturity • Bank to demonstrate that it meets **OFs and MREL requirements** • By a **margin** that the **RA sets in agreement with the CA**	Permission to replace EL with OFs prior to their contractual maturity • Bank to demonstrate that replacement is **necessary to comply with OF requirements**

2. General prior permission for reducing capital and eligible liabilities

Possibility to grant a general prior permission (GPP) for a predetermined amount and for a limited period of time - a concept previously foreseen for OFs by Level 2 – now introduced in Level 1 text, both for OFs and ELs

Commonalities of GPP for own funds and eligible liabilities:

- Institutions to provide sufficient safeguards as to their capacity to operate with own funds and eligible liabilities above the regulatory minima laid down in CRR, CRD and BRRD.
- GPP is granted only for a certain period of time, not exceeding one year
- GPP is granted for a certain predetermined amount

GPP for reducing OFs, Art. 78(1) 2nd subparagraph

Predetermined amount set by the CA, within the following limits:

- For CET1, this amount shall be < 3% of relevant issue and < 10% of surplus CET1 plus a margin that the CA deems necessary
- For AT1 or Tier 2, this amount shall be < 10% of relevant issue and < 3% of total amount of outstanding AT1 or Tier 2

GPP for reducing EL, Art. 78a(1) 2nd subparagraph

Predetermined amount set by RA, as framed in Article 32c of the RTS:

- This amount shall be < 3% of the total amount of outstanding EL

-> same starting point as for OFs but question for consultation

- No limit in percentage of individual debt issuance as for OFs, in order to allow for redemption of an entire issuance

Ex ante, RA to consult the CA.

2. Further implications of introduction of GPP in level 1 for own funds

CRR2 taking up the concept of GPP has implications for other regimes in the area of own funds that existed already under the current RTS:

Permission to repurchase capital instruments to pass on to employees as remuneration

- To be dealt with within the GPP context; requirement to inform CA is upheld – see Article 28(4) draft RTS

Redemption of cooperative shares

- Special regime for redemption of CET1 instruments issued by mutuals, cooperative societies and alike as framed by existing RTS Article 32 to be upheld and kept unchanged, including maintenance of current limit of 2%

  ⇨ deemed to function well and better reflect the specificities of such institutions and the special nature of their shares

2. Permission regime – procedure: information, notice period and deduction (1)

Information requirements to support any prior permission

- The RTS now details the exact type of information to be submitted along with a request for prior permission -> Requirement not new but specified now in more detail to cross-refer to the different prudential requirements set out by CRR, CRD and BRRD

Notice period for application to reduce own funds and eligible liabilities

- Application period is raised from 3 to 4 months

  a) for reducing OFs:

  ⇨ To cater for more complex assessment the CA has to undertake i.e. checking that institutions' OFs and ELs exceed requirements by a margin deemed necessary

  ⇨ essential as CAs will need to interact with RAs on eligible liabilities (supply/demand)

  b) For reducing EL:

  ⇨ To allow sufficient time for RA's interaction with relevant CA as prescribed by Article 78a(3)(a) CRR

- As GPP – both for OFs and EL - may be granted only for limited time period ≤ 1 year and application period is 4 months, it was considered whether time period could be shortened for GPP (or its renewal) or whether information requirements could be lowered in the latter case

  ⇨ The topic is acknowledged for stakeholders to comment

2. Permission regime – procedure: information, notice period and deduction (2)

Moment of deduction from own funds and eligible liabilities

- Deduction obligation is an inherent feature of a general prior permission regime
- Originally introduced in the area of OFs to prevent institutions from operating at a level of capital which fails to reflect that part of that capital is already foreseen to disappear and will not be there any longer to absorb losses; same logic is applicable to eligible liabilities
- General deduction rule for OFs is kept unchanged for individual permissions and taken over also for EL: Institutions have to deduct corresponding amount upfront from the moment sufficient certainty exists and supervisory permission has been granted
- For the case of GPP, more explicit rules are introduced requiring institutions to deduct the predetermined amount from the moment the permission is granted

  ⇨ Important both for disclosure and compliance purposes. Ensures that prior permission will not be exercised at the detriment of compliance with requirements

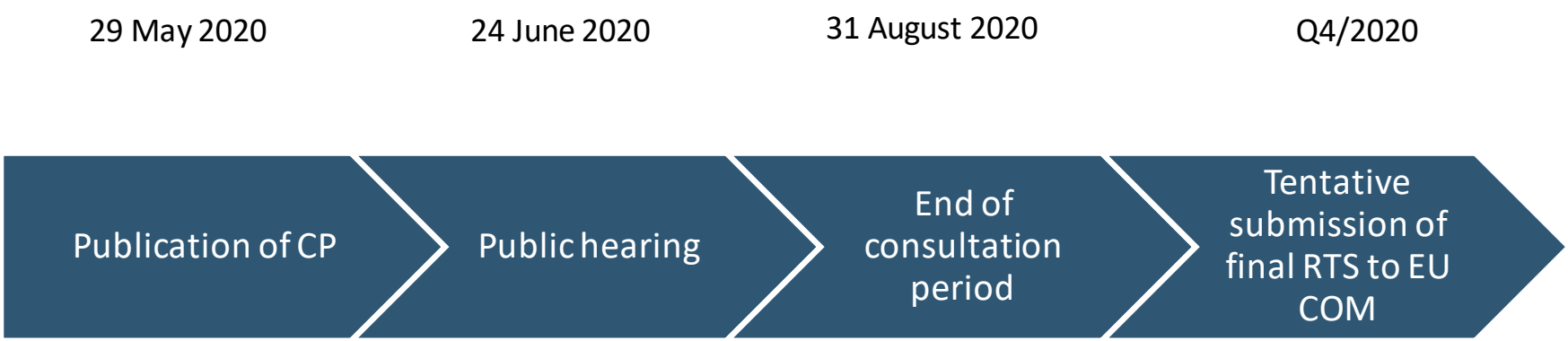
Further issues for consideration

- Whether to introduce flexibility on limits and information for liquidation entities and subsidiaries exempted from internal MREL
- In addition, according to Level 1 text, permission regime to apply as well to eligible liabilities not subordinated to excluded liabilities and where one year maturity requirement is not met anymore

  ⇨ All aspects acknowledged for stakeholders to comment

3 – NEXT STEPS

3. Next steps


29 May 2020
24 June 2020
31 August 2020
Q4/2020
Publication of CP
Public hearing
End of consultation period
Tentative submission of final RTS to EU COM

4 – QUESTIONS

4. Questions

- Feedback on issues presented in the slides:

1) Full alignment of rules on direct and indirect funding for eligible liabilities with own funds
2) Information requirement to support any prior permission for reducing OFs or EL
3) Notice period for the application for prior permission and GPP
4) Deduction upon obtaining a prior permission or GPP
5) Limits for GPP for reducing eligible liabilities

- Any other aspect deemed relevant

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