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**EBA-2018-D-2167**

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**Subject: HSBC Holdings plc – Redesignation of Tier 2 Discount Perpetual Capital Securities**

Dear Sirs,

I refer to the letters you sent to me on 8 June and 19 July 2018 in which you explained several concerns you had relating to the redesignation by HSBC Holdings plc (announced on 4 May 2018) of just under US\$ 2 billion of certain discount perpetual Tier 2 capital securities (the ‘Discos’) and raised some specific questions relating to their eligibility as Tier 2 capital and MREL liabilities, respectively.

As you rightly point out in your letter of 19 July, one of the tasks of the EBA is to ensure consistent, efficient and effective application to the acts referred to in Article 1(2) of the EBA founding Regulation, which includes the application of the criteria on the quality of own funds instruments laid down in the Capital Requirements Regulation (‘CRR’). More specifically, the EBA is also entrusted by the CRR, amongst others, with the task of monitoring the quality of such instruments across the Union.

In order to perform those tasks, the EBA may make use of its available (non-binding) powers, such as the issuance of monitoring reports and/or opinions. The monitoring reports, in many instances, reflect issues addressed through another practical instrument, the Question and Answer (‘Q&A’) tool. At the same time, in a gradually escalating process of policy formation this may later also involve other steps such as the issuance of recommendations or guidelines, which are subject to the ‘*comply or explain*’ mechanism.

Specifically, in the context of the above mentioned redesignation or ‘*reclassification*’ of own funds announced by HSBC Holdings plc, and in response to the first question (1) raised in your letter of 19 July, I would like to inform you that the EBA has generally assessed the issue of reclassification of own funds from a grandfathered category to a fully eligible category. The results of this assessment have resulted in an EBA answer provided through the Q&A tool: Q&A 2018\_4417.

In its answer, the EBA has concluded that reclassifications of own funds instruments as described, i.e. from a grandfathered category to a fully eligible category, although unusual, are not prohibited as such by the CRR.

However, the EBA answer recalls that, as explained in the introductory recitals of the CRR (recitals 78 and 119), the general purpose of the grandfathering provisions as they relate to own funds is to ensure an appropriate continuity in the level of own funds, while also ensuring that institutions have sufficient time to meet the new required levels and definitions of own funds and that certain capital instruments that do not comply with the definition of own funds laid down in the CRR are phased out. To the extent that grandfathering allows for deviations from the new criteria on the quality of own funds instruments those deviations should be limited to the largest extent possible. The possibility for institutions to benefit from a grandfathered treatment should therefore be subject to strict conditions.

In cases where institutions operate such reclassifications, very close scrutiny should be exercised by the competent authority on the reasons for such a reclassification, in particular in contexts where no change in the relevant applicable laws or terms and conditions of the instruments has taken place prior to the reclassification, the reclassification has a significant impact on the capital ratios or any forthcoming changes to the CRR and related new grandfathering provisions in relation to eligibility of own funds are likely to come into force.

According to Q&A 2018\_4417, the assessment in substance on the eligibility of the instruments elected for reclassification should be the same as the one applicable to every new issuance (being AT1 or Tier 2). As such, institutions should consider the terms and conditions of the relevant instruments at issuance. These terms and conditions need to be assessed against the rules applicable at the moment of the reclassification of the instrument. These rules encompass the relevant regulatory provisions stemming from Part Two (Own funds) and Part Ten, Title I (Transitional Provisions) of the CRR and Regulatory and Implementing Technical Standards, as supplemented by related guidance for the consistent and effective application of the regulatory framework provided via EBA Q&As or reports (currently the most recent available version of the EBA AT1 monitoring report) available at the time of the reclassification.

The EBA concludes that the above answer would only apply in cases where an institution has elected to change the prudential treatment previously adopted for an instrument, with the consequence that the instrument would be cascaded 'up' and treated as fully eligible in the same tier/a higher tier of capital whereas it was previously grandfathered, and that the same principles should apply by analogy to cases where own funds instruments would be reclassified from a

disqualified category to a fully eligible category.

In response to your second (2) and sixth (6) questions of the same letter of 19 July, it is worth recalling that EBA Q&A 2013\_544 mentions that ‘any call options, redemptions or repurchase transactions related to Tier 2 instruments must meet the requirements of Article 63(i), (j) and (k) of Regulation (EU) No. 575/2013 (CRR). For Tier 2 instruments, Article 63(j), in conjunction with Article 77 of the CRR, stipulates that the institution must not effect the call, redemption, repayment or repurchase prior to the date of an instrument's contractual maturity without the prior permission of the competent authority. *Such instruments should therefore contain an explicit reference to these regulatory conditions in their terms*’.

Nevertheless, and in response to your related third (3) question, any capital instrument qualifying and being disclosed as a Tier 2 instrument is subject, by operation of law, to the regulatory regime set out in the CRR and therefore any call, redemption or repurchase may not take place without the prior authorization of the relevant competent authority. In this regard, it is also worth noting that, in accordance with Article 3 of Commission Implementing Regulation (EU) No 1423/2013 laying down implementing technical standards with regards to disclosure of own funds requirements for institutions according to Regulation (EU) No 575/2013 of the European Parliament and of the Council, in order to meet the requirements for disclosure of the main features of Tier 2 instruments issued by them, institutions must complete and publish the capital instruments’ main features template, which includes the obligation to specify whether any issuer call option is subject to prior supervisory approval.

Regarding the fifth (5) question raised in your letter of 19 July, given its specific character we think it is more suitable to be dealt with through the Q&A tool as well. As you may know, the process of Q&A relies heavily on the cooperation and support of experts from national authorities, the Commission as well as EBA staff. Therefore, I invite you to submit this or any other specific questions you may have through that tool.

On the uncertainty raised in your letter of 8 June about the Discos’ MREL eligibility, this latter would depend first on the eligibility of the concerned instruments as fully eligible Tier 2 instruments in the first place. MREL eligibility criteria under the Bank Recovery and Resolution Directive (*‘BRRD’*) would apply in addition to determine whether the Discos would be counting towards the MREL requirement of the bank. In this regard, we note two relevant issues.

First, pursuant to Article 55 of the BRRD, instruments governed by third country law must either contain contractual terms that would ensure the effectiveness of write down and conversion powers exercised by resolution authorities of a Member State, or alternatively this outcome must

be secured by the existence of provisions of the law of the third country or a binding international agreement. Pursuant to Article 45 of the BRRD, if the resolution authority is not satisfied that any decision would be effective under the law of that third country, the liability shall not be counted towards the minimum requirement for own funds and eligible liabilities.

Second, whether instruments will count towards the MREL requirements of the bank may depend on specific criteria in the MREL policy of the Bank of England and the resolution plan, including for example the identification of resolution entities and whether the Bank of England's policy would recognize as eligible issuances made from non-resolution entities.

Please be aware that we have liaised with the Prudential Regulation Authority ('PRA') and the Bank of England's Resolution Directorate, informing them of the above EBA stance on the reclassification of own funds instruments as laid down in Q&A 2018\_4417, and EBA considerations on the Discos' eligibility as MREL liabilities of those reclassified instruments that are governed by a third country law, respectively. However, the final decision on the assessment of the compliance of the Discos with the CRR Tier 2 eligibility criteria, including their eligibility as MREL liabilities lies, respectively, with those authorities.

Likewise, regarding the doubts raised in the fourth (4) question of your letter of 19 July about the compliance by the Discos with the 'whole subordination' criterion specified in Article 63(d) of the CRR, in particular about the meaning of the terms 'Senior Creditor' or 'solvent' included in their terms and conditions and about the effects of the provisions on the conversion of Discos into preference shares in the event of a bail-in of these securities, we have forwarded those concerns to the Prudential Regulation Authority ('PRA') and the Bank of England's Resolution Directorate for further detailed assessment.

Finally, in relation to the concerns raised in your letter of 8 June regarding the alleged lack of transparency of HSBC Holdings plc towards its clients on the potential treatment of the Discos in resolution or insolvency, remain assured that we will also be informing ESMA about those concerns.

The EBA intends to publish this letter on its website. Please inform us should you have any objections to publication.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Andrea Enria'.

Andrea Enria