



# **EBA REPORT ON THE MONITORING OF CET1 INSTRUMENTS ISSUED BY EU INSTITUTIONS — SECOND UPDATE**

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**EBA**

EUROPEAN  
BANKING  
AUTHORITY

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# 1. Executive summary

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## 1.1 Reasons for publication

1. Pursuant to Article 80 of Regulation (EU) No 575/2013 (Capital Requirements Regulation — CRR<sup>1</sup>) on the continuing review of the quality of own funds, the 'EBA shall monitor the quality of own funds instruments issued by institutions across the Union and shall notify the Commission immediately where there is significant evidence of those instruments not meeting the criteria set out in Article 28 or, where applicable, Article 29'.
2. Pursuant to this Article, the EBA has been continuously monitoring the quality of Common Equity Tier 1 (CET1) issuances in the EU since 2013. In addition, in line with Article 26(3) of the CRR, it has regularly maintained and published a list of all forms of capital instruments in each Member State that qualify as CET1. The EBA published its first list of CET1 instruments in the EU on 28 May 2014<sup>2</sup>, and seven subsequent updates, on 23 December 2014<sup>3</sup>, 21 October 2015<sup>4</sup>, 8 September 2016<sup>5</sup>, 1 December 2016<sup>6</sup>, 23 May 2017<sup>7</sup>, 17 November 2017<sup>8</sup> and 20 July 2018<sup>9</sup>. The latest revision, accompanying this report, is the eighth update.
3. Together with the fifth publication of the list, the EBA published the first CET1 report<sup>10</sup>, providing background information on the work carried out to establish this list. The present EBA monitoring report on CET1 issuances is the second update of the CET1 report. It provides external stakeholders with:
  - further guidance on the content and objectives of the published CET1 list;
  - clarity on the consequences of the inclusion (or exclusion) of an instrument in (or from) the list;
  - feedback on the outcome of the EBA monitoring work on CET1 issuances across the EU.
4. The EBA intends to update this report regularly, when necessary, to explain how it takes into consideration new developments in CET1 issuances and market practices. Depending on those developments and the materiality of changes to the list, further updated versions of this report

<sup>1</sup> Unless otherwise specified, legal references in this report are made to the text of the CRR in its version before it was amended by the Regulation (EU) No 2019/876 of the European Parliament and of the Council of 20 May 2019 amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements, and Regulation (EU) No 648/2012 (OJ L 150, 7.6.2019, p.1, CRR2).

<sup>2</sup> <https://eba.europa.eu/-/eba-publishes-list-of-common-equity-tier-1-cet1-capital-instruments>

<sup>3</sup> <https://eba.europa.eu/-/eba-updates-list-of-common-equity-tier-1-cet1-capital-instruments>

<sup>4</sup> <https://eba.europa.eu/-/eba-updates-list-of-common-equity-tier-1-cet1-capital-instrumen-1>

<sup>5</sup> <https://eba.europa.eu/-/eba-updates-its-cet1-list>

<sup>6</sup> <https://eba.europa.eu/-/eba-updates-list-of-cet1-instruments>

<sup>7</sup> <https://eba.europa.eu/-/eba-updates-on-monitoring-of-cet1-instruments>

<sup>8</sup> <https://eba.europa.eu/-/eba-updates-list-of-cet1-instrumen-1>

<sup>9</sup> <https://eba.europa.eu/-/eba-updates-on-monitoring-of-cet1-capital-instruments>

<sup>10</sup> <https://eba.europa.eu/documents/10180/1853774/EBA+CET1+report+-+Q2+2017.pdf>

may be developed. When they are, they will be published at the same time as the relevant update(s) to the CET1 list.

## 1.2 Content of the report and main findings

5. The CRR lays down eligibility criteria for CET1 instruments (in particular in Articles 26 to 31). Those criteria are supplemented by Commission Delegated Regulation (EU) No 241/2014 as amended by subsequent regulations, which incorporates around 20 of the draft regulatory technical standards (RTS) on own funds that the EBA delivered to the Commission in this area ('RTS on own funds'). Following the completion of the regulatory framework the EBA has placed greater emphasis on the review of the implementation of the eligibility criteria applicable to capital instruments on the basis of the CRR and the RTS. The assessments and/or findings included in this report are based on CRR1 provisions applicable at the time of the review, in particular with regard to EBA powers, which were in place prior to the introduction of the amendments to the CRR provisions set out by the CRR2.
6. As regards CET1 instruments, the EBA has primarily focused its work on compiling the list of existing forms<sup>11</sup> of CET1 instruments issued prior to the entry into force of the CRR (before 28 June 2013). These initial instruments were included in the first CET1 list published by the EBA on 28 May 2014 and were based on the information received from competent authorities. Since then, new forms of CET1 instruments have been issued by institutions in the EU, and the EBA has assessed the terms and conditions of all these new forms of CET1 instruments against the regulatory provisions (as defined in Article 28 or, where applicable, Article 29 of the CRR, complemented by the applicable RTS) to identify provisions governing the instruments that the EBA considers contradict the eligibility criteria, and with a view to updating the CET1 list.
7. This report is structured as follows: section 2 provides insights into the purpose and content of the CET1 list. Section 3 provides clarification on the EBA's monitoring role and the consequences of the inclusion/exclusion of an instrument in/from the list. Section 4 is dedicated to the assessment of CET1 issuances. It includes the EBA's views on some of the provisions of the CET1 instruments reviewed (lessons learnt) to serve as general guidance for future potential issuances. Section 5 reviews some other issues related to CET1 issuances that were dealt with in the context of the EBA's Q&A process. The Annex includes the legal provisions that form the background to the discussion.
8. Since the first publication of the list<sup>12</sup>, and based on the information received by each competent authority, the EBA has included in the list 16 new forms of instruments issued after the entry into force of the CRR. A few pre-CRR instruments, whose terms have been amended, have also been assessed with the aim of ensuring compliance with the new regulatory requirements stemming from the CRR and RTS.

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<sup>11</sup> The terms 'form' and 'type' of instruments are used interchangeably throughout this report.

<sup>12</sup> In the case of a withdrawal of the UK from the EU pursuant to Article 50 of the Treaty on European Union (TEU), and barring any transitional arrangements that may be specified in the withdrawal agreement, the capital instruments that qualify as CET1 instruments in the UK will be removed from the list accordingly in its next update.



9. The EBA requested some amendments to the terms and conditions of the instruments in several cases. The amendments related in particular to permanence and loss absorption, and, most frequently, to flexibility of payments with regard in particular to the following features: preference in the order of payments, indication of distribution policies in the terms and conditions of the instruments, reinstatement of voting rights in the absence of dividends, and covenants/side agreements deemed to undermine the flexibility of payments. Other aspects are currently under assessment by the EBA.

## 2. EBA CET1 list: purpose and content

### 2.1 Legal mandate

10. According to the CRR<sup>13</sup> — recital 74, Article 26(3) and Article 80(1) (see Annex) — the EBA is required to:

- maintain and publish a list of all the forms of capital instruments in each Member State that qualify as CET1;
- monitor the quality of own funds instruments and notify the Commission immediately where there is significant evidence of those instruments not meeting the criteria set out in Article 28 or, where applicable, Article 29.

11. The EBA may, after the review process set out in Article 80 and when there is significant evidence of those instruments not meeting the criteria set out in Article 28 (or, where applicable, Article 29), decide to remove non-state aid capital instruments issued after 28 June 2013 from the list and may make an announcement to that effect as per Article 26.

### 2.2 Changes introduced by CRR2 with regard to EBA powers in particular

12. As part of the banking package, and taking as a basis the EBA ‘Opinion on own funds’ in the context of the CRR review published on 23 May 2017<sup>14</sup>, the CRR has been amended with regard to own funds and in particular with regard to EBA powers in relation to the CET1 list.

13. To guarantee the enforceability of the CRR and RTS provisions for CET1 instruments for all institutions in the EU and to ensure a harmonised and consistent application of the eligibility criteria, the CRR2 reinforces the EBA’s role in terms of CET 1 instruments. It is worth noting, in particular, that the EBA will need to be consulted on an *ex ante* basis in future for new forms of instruments that are not yet included in the CET1 list. To this end, the third subparagraph of the new Article 26(3) of the CRR2 determines that competent authorities must consult the EBA before granting permission for new forms of capital instruments to be classified as CET1 instruments. In doing so, they must have due regard to the EBA’s opinion and, where the competent authorities decide to deviate from it, they must write to the EBA within 3 months from the date of receipt, setting out the rationale for deviating from the relevant opinion.

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<sup>13</sup> Unless otherwise specified, legal references in this report are made to the text of the CRR in its version before it was amended by the *Regulation (EU) No 2019/876 of the European Parliament and of the Council of 20 May 2019 amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements, and Regulation (EU) No 648/2012* (OJ L 150, 7.6.2019, p.1, CRR2).

<sup>14</sup> Opinion of the European Banking Authority on own funds in the context of the CRR review:

<https://eba.europa.eu/documents/10180/1853903/EBA+Opinion+on+own+funds+in+the+context+of+the+CRR+review+%28EBA-Op-2017-07%29.pdf>

14. Under the new regime, the EBA will be able not only to add (new) instruments to the list but also to remove instruments from the CET1 list, as the case may be, and make an announcement to that effect. Finally, pursuant to the fourth subparagraph of Article 26(3) of CRR2, the EBA may explicitly request any information from competent authorities in connection with CET1 instruments that it deems necessary to establish compliance with the criteria set out in Article 28 or, where applicable, Article 29 and for the purposes of maintaining and updating the CET1 list.
15. In addition, based on the aforementioned EBA Opinion, it is worth mentioning that the new Article 79a of the CRR2 expressly includes a principle whereby institutions, when assessing compliance with regulatory requirements laid down in Part II of the CRR, must have regard to not only the legal form but also the substantial features of the instruments. To achieve this aim, the article requires institutions to take into account all arrangements related to the instruments, even when they are not explicitly set out in the terms and conditions of the instruments themselves.

## 2.3 Publication of the list

16. The CET1 list was first published by the EBA on 28 May 2014, based on the information received from the 28 competent authorities across the EU on existing types of instruments as at 28 June 2013 (i.e. issued before the entry into force of the CRR). The list published included all the CET1 instruments issued by EU institutions, as were fully eligible or grandfathered under CRR provisions, based on the assessment of competent authorities. It gave for the first time an exhaustive overview of the CET1 capital instruments available in EU Member States. At this first publication, the EBA did not perform any monitoring or analysis of the instruments included in the list.
17. After that first publication of the list, the EBA continued to monitor issuances of all new types of CET1 instruments issued in the EU after 28 June 2013 (i.e. after the entry into force of the CRR). As a result, new types of CET1 instruments have been continuously added to the list after analysis of their features and confirmation of compliance with the eligibility criteria for CET1 instruments. Consequently, the list, as it now stands, contains two types of instruments: the instruments existing before 28 June 2013 and the instruments issued after that date.
18. The list has been regularly updated to cover in particular the following situations:
- the inclusion of new forms of instruments that have been assessed as eligible with regard to the requirements for CET1 instruments (highlighted in yellow in each new publication of the list);
  - the deletion of some existing instruments, the forms of which are not used any more, or amendments to some information or legal references to existing forms of instruments (highlighted in orange and strikethrough in each new publication of the list);
  - amendments to/review of some existing instruments already on the list that have been modified after the original listing or that introduced variations from their governing law, in a way that sometimes required a new assessment.



19. There is no pre-established frequency of publication of the list, which is updated on an ongoing basis<sup>15</sup>, depending on the number of new types of instruments created or the need to review existing instruments.

## 2.4 Content and features of the list

20. The information provided in the EBA CET1 list is consistent with the information to be disclosed in accordance with Commission Implementing Regulation (EU) No 1423/2013 of 20 December 2013, which incorporates the Implementing Technical Standards (ITS) on disclosure for own funds. In particular, the following information is provided in the list:

### **Country of the issuance (column 1 of the published list)**

21. This column refers to the jurisdiction where the type of instrument has been issued.

### **Name of the instrument (column 2 of the published list)**

22. This column refers to the name of the type of instrument in English and in the national language.

23. The types of instruments listed do not refer to individual issuances. Two instruments with identical substantive features and terms and conditions, except, for instance, the level of their multiplier for dividends, are deemed to be the same type of instrument. If differences are material, then the instrument must be considered a new type and reported as such.

24. It has to be recalled that the list includes only CET1 items in the form of 'instruments', as referred to in the first subparagraph of Article 26(3) of the CRR; it does not include any other CET1 items. In particular, share premiums and other capital dotations/contributions or reserves are not included in the list, as they are covered by separate provisions of the CRR.

### **Governing law of the instrument (column 3 of the published list)**

25. This column refers to the local laws governing the type of instrument.

### **Whether or not the instrument can be issued in addition to other CET1 instruments (column 4 of the published list)**

26. This refers to cases in which an institution can issue a second type of instrument (with or without conditions attached to that issuance), in addition to the instruments that institutions are required to issue based on their legal entity status, and where there is at least one instance of actual issuance of such CET1-eligible instruments in the relevant Member State. Therefore, a non-voting share will be featured as being issued 'in addition to' common shares if (i) such a non-voting share qualifies as CET1 and (ii) this type of non-voting share has actually been issued in practice and is not only a theoretical possibility. The same could apply to non-joint stock companies if applicable national law allows these institutions to issue a second type of CET1 instrument in addition to cooperative shares. In conclusion, the reference to an instrument as

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<sup>15</sup> In the case of a withdrawal of the UK from the EU pursuant to Article 50 of the Treaty on European Union (TEU), and barring any transitional arrangements that may be specified in the withdrawal agreement, the capital instruments that qualify as CET1 instruments in the UK will be removed from the list accordingly.



being issued in addition to another does not mean that there is necessarily a joint issuance of those instruments, or that the holders of both instruments are the same; it means only that it is possible for institutions to include the two instruments in their CET1.

### **Whether or not the instrument includes voting or non-voting rights (column 5 of the published list)**

27. This column refers to various possible cases: full (for the instrument with full or the highest voting rights), fewer and no voting rights. The voting rights can be defined by contractual or statutory terms. The answer should always be full, fewer or none, or a combination of those three choices if more than one is possible under statutory or contractual terms. It is important to get some information on the voting rights of the types of instruments.

28. It is worth recalling that the terms governing the form of a CET1 instrument can allow for differentiated voting rights in the sense of different quantities of votes per capital unit subscribed (this is usually the case for mutuals, cooperative societies, savings institutions and similar institutions, as listed in the RTS on own funds). This is also meant to allow for differentiated distribution. Instruments with a reduced number of voting rights compared with other full voting instruments issued by the institution have 'fewer or no voting rights' and may have higher distributions. Preference can be in the amount (multiple distribution) but not in the order of payments (no priority preference), in accordance with Articles 28(1)(h) and 28(4) of the CRR and the limits of the EBA RTS on own funds (part 4) on multiple dividends.

### **Whether or not the instrument is fully eligible under Article 28 or Article 29 of the CRR (column 6 of the published list)**

29. The forms of instruments reported in this column meet fully (i.e. they are not subject to any grandfathering provisions) the eligibility criteria of the CRR and corresponding RTS on own funds, either under Article 28 (CET1 instruments — 'joint stock' companies) or Article 29 ('non- joint stock' companies — mutuals, cooperative societies, savings institutions and similar institutions).

30. With the third update of the list, all pre-CRR instruments on the list were assessed by competent authorities against the Commission Delegated Regulation (EU) 2015/850, which incorporated the EBA RTS on own funds (part 4) on multiple dividends, as this was not yet in force when the previous versions of the list had been published. Following this assessment, no instrument has been removed from the list.

### **Whether or not the instrument is a non-state aid instrument (columns 7 of the published list)**

31. Column 7 refers to instruments treated under Article 484 of the CRR, referring to grandfathered non-state aid instruments that used to qualify as own funds under national transposition measures for Directive 2006/48/EC<sup>16</sup>.

<sup>16</sup> Grandfathered state aid instruments issued under Article 483 of the CRR had previously been included in the list. After their grandfathering status expired at the end of 2017, they were deleted with the publication of the eighth version of the CET1 list - published in July 2019 - as these instruments no longer form part of the eligible CET1 instruments.

32. Regarding such grandfathered non-state aid instruments, it is to be noted that some instruments in some jurisdictions are/have been modified to be made fully eligible with CRR provisions. These may be/may have been reported originally as grandfathered, but may appear/may have appeared as fully eligible in subsequent versions of the list.

### **Whether or not the instrument is a capital instrument subscribed by public authority in emergency situations as per Article 31 of the CRR (column 8 of the published list)**

33. When updating the CET1 list for the third time, the EBA considered a new type of instrument issued in one jurisdiction (namely Greece): capital instruments subscribed by public authorities in an emergency situation as per Article 31 of the CRR. New columns were added to the list for this purpose. At a second stage, another type of instrument, also eligible under Article 31 of the CRR, issued in another jurisdiction (namely Belgium) was added.

34. In the case of capital instruments subscribed by public authorities in emergency situations under Article 31(1) of the CRR, where the relevant competent authority has considered that the capital instruments are equivalent to CET1 instruments, and has made a reasoned request to the EBA, the EBA has included those instruments in the list as CET1 equivalent in accordance with Article 31(2) of the CRR. However, given the particular nature of state aid instruments, their inclusion in the list does not necessarily imply that it would be appropriate to extend specific features or provisions of these capital instruments to other institutions in the relevant Member State (see section 3.3).

## **2.5 Number of types of instruments listed**

35. At the time of publication of the eighth update of the list, accompanying this CET1 report, the number of instruments reported for the 28 EU jurisdictions is 117<sup>17</sup>, ranging from one form of instrument in four jurisdictions (BG, CY, EE, SI) to 10 or more forms of instruments in three jurisdictions (AT, DE, FR).

36. Of the 117 forms of instruments, 63 forms of instruments (54%) have been issued under Article 28 of the CRR and reported as fully eligible (none of them being grandfathered), and 33 forms of instruments (28%) have been issued under Article 29 of the CRR (instruments issued by mutuals, cooperative societies, savings institutions and similar institutions) and reported as fully eligible. Nineteen of the remaining instruments reported (16%) are forms of instruments grandfathered under the CRR as non-state aid instruments (AT, DE, FI, FR, HR, IT, MT, PL, PT, RO), while two instruments (2%) are capital instruments subscribed by public authorities in emergency situations as per Article 31 of Regulation (EU) No 575/2013 and are considered equivalent to CET1 instruments. As already mentioned, the grandfathering of state aid instruments issued under Article 483 of the CRR elapsed at the end of 2017. Since this date, instruments are not part of eligible CET1 instruments anymore and have been removed from the list. Based on the information communicated by all jurisdictions concerned (namely AT, BE,

<sup>17</sup> Ordinary shares or equivalent instruments being counted several times (as one form of instrument in each jurisdiction and not as one instrument for the whole of the EU, since there is no common definition of ordinary shares/common shares).

DE, EL, ES, IT, LT, LV, PT), all instruments have been deleted from the list. Most of these instruments have been either repaid or converted into fully eligible instruments and are now already included in the CET1 list or are no longer used. One instrument has been transformed into a state aid instrument under Article 31 of the CRR.

	Number
<b>Total number of CET1 instruments</b>	<b>117</b>
<i>of which issued after CRR implementation</i>	<i>16</i>
<i>of which fully eligible under Article 28</i>	<i>63</i>
<i>of which fully eligible under Article 29</i>	<i>33</i>
<i>of which grandfathered non-state aid instruments</i>	<i>19</i>
<i>of which subscribed by public authorities as per Article 31</i>	<i>2</i>

37. In addition, the EBA has investigated further provisions in the national corporate laws in terms of the proportion of non-voting shares compared with voting shares. Overall, the majority of EU jurisdictions require some limitation in the issuance of non-voting shares, which may commonly be up to 50% of share capital. Only in a very few jurisdictions are non-voting shares not permitted at all.

38. In terms of the proportion of the shares to be paid at inception and the period for which the shares can retain their status as ‘not fully paid up’, the provisions of national laws across jurisdictions are diverse and in some cases differ depending on (i) whether the issuance is on initial registration of the entity or subsequent to that, (ii) whether or not portions of the shares are paid up in kind instead of cash, where this is allowed in the jurisdiction, or (iii) the type of entity (e.g. cooperative, public, private). Overall, based on the survey results as observed in national corporate laws, share capital needs to be fully paid up (either at all times or only on authorisation) followed by the requirement that at least 25% of share capital is paid up together with any share premium to be paid up in full. The timing for payment of share capital also differs across jurisdictions: many Member States provide no time limit or requirements on an ad hoc basis in the articles of association or the issuance or the competent authority’s decision, while fewer Member States require a maximum time of 5 years<sup>18</sup>. In some jurisdictions there is also the restriction that subsequent capital increases are allowed only if previous outstanding amounts are fully paid up, which may raise some prudential concerns, as this could limit the capacity of the institution to raise further capital when needed.

39. Furthermore, the EBA discussed some provisions in national legislation describing the different possibilities under which a share can be considered as being paid up. In this respect, an undertaking/commitment to pay cash to the institution on demand or at an identified or

<sup>18</sup> It should be recalled that only the part of capital instruments that is paid up can be counted as CET1 capital for prudential purposes. This is reinforced by the new subparagraph at the end of Article 28(1) of the CRR2, which states: ‘For the purpose of point (b) of the first subparagraph, only the part of a capital instrument that is fully paid up shall be eligible to qualify as a Common Equity Tier 1 instrument.’

identifiable future date<sup>19</sup> cannot be considered to meet the requirements of Article 28(1)(b) of the CRR specifying that the instruments are paid up, in particular under the need to ensure that CET1 instruments are constantly available to the institution without intermediary actions/decisions as the first backstop to losses as they occur.

40. Finally, the EBA considered two additional implications of shares not being fully paid up, namely i) with regard to the allocation of profits and ii) regarding the distribution of residual assets. In several cases, provisions in national laws provided for particular methods for the distribution of profits and/or of residual assets.
41. Concerning the allocation of profits, the EBA has no concerns about such provisions regarding the eligibility of instruments as long as the shares are fully paid up.
42. Regarding the distribution of residual assets, provisions in some national laws foresee that the distribution be made *pari passu* across all shares in proportion to the number of shares in the share capital also in cases where contributions to share capital have not been fully paid up or not in the same proportion for all shares of the same nominal value. Here, the provision of Article 28(1)(k) of the CRR needs to be recalled, which requires the instruments to entitle their owners to a claim on the residual assets that is proportionate to the amount of such instruments issued, while only the part of the instrument that is fully paid up is eligible as CET1 capital.
43. More generally, situations in which shares are not fully paid up may create issues with regard to *pro rata* distributions. While only the part of capital instruments that is paid up can be counted as CET1 capital for prudential purposes, the EBA believes that it is more appropriate from a prudential perspective to ensure that all shares are fully paid up.

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<sup>19</sup> This would be the case, for example, for provisions with the following or similar wording: 'For the purposes of this part a share in a company shall be taken to have been paid up (as to its nominal value or any premium on it) in cash or allotted for cash if the consideration for the allotment or the payment is [...] an undertaking to pay cash to the company on demand or at an identified or identifiable future date which the directors have no reason for suspecting will not be complied with.'

## 3. The EBA's role in CET1 monitoring and implication of the inclusion of forms of instruments in the list

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44. The assessments included in Parts 3.1 and 3.2 of this section are based on the eligibility criteria applicable at the time of the review and therefore before the introduction of the amendments to the CRR provisions set out by the CRR2. Amended CRR provisions and their implementation in EBA's work and processes will be reflected in the next version of the CET1 report.

### 3.1 Exhaustiveness of the list and consequences of non-inclusion in the list up to July 2019

45. According to the first subparagraph of Article 26(3) of the CRR, it is for competent authorities to evaluate whether or not issuances of CET1 instruments meet the criteria of the CRR and the RTS; according to the same provisions, competent authorities may consult the EBA. The CRR nevertheless qualifies and frames the discretion of the competent authorities in various ways.

46. Firstly, the third subparagraph of the same article mandates the EBA to establish, maintain and publish a list of 'all' the forms of CET1 instruments in each Member State, and to do so 'on the basis of information' from each competent authority. This implies, first and foremost, an obligation on competent authorities to notify the EBA of anything that constitutes a new form of CET1 instrument, as otherwise the obligation on the EBA to maintain the CET1 list would be impossible to achieve and would render the relevant provision 'empty'<sup>20</sup>.

47. Furthermore, as the list is expected to contain 'all' of the CET1 instruments, this implies that the CET1 list is expected to be exhaustive and that it aims to gather in a single document all the existing CET1 forms of instruments in the EU that comply with CRR requirements and relevant RTS to provide market participants with an exhaustive and transparent view of all eligible CET1 instruments used by institutions in the EU<sup>21</sup>.

48. Conversely, the idea of the exhaustiveness of the CET1 list would also imply that the forms of capital instruments that are not included in the list because they are not considered eligible shall not be included in the CET1 capital of EU institutions. For the case in which a competent authority approves instruments as eligible CET1 instruments, but the EBA sees a material complexity, the second subparagraph of the same Article 26(3) of the CRR provides for an explanation to the EBA by the competent authority of its rationale for so doing. It might not be

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<sup>20</sup> Where competent authorities would disagree with the EBA on the characterisation of a new issuance as a new or existing form of CET1 instrument, the same guidance should apply as that in the next paragraph with regard to the second subparagraph of Article 26(3) and the discrepancy in views between the competent authority and the EBA: in order for it to be possible for the EBA to review the list and remove non-state aid instruments from it, the EBA would need to be able to review and also opine on whether the substance/merit of the instrument in question is considered new or falls under an existing form of capital instrument.

<sup>21</sup> Save for a potential time delay between the evaluation of a type of instrument and the effective publication of the list.

explicit, at this point, with regard to what happens if the EBA continues not to be convinced by the reasoning provided by the competent authority. Nevertheless, both the third subparagraph of this article and Article 80 provide for general EBA review powers of CET1 eligibility of instruments and for powers to remove instruments from the list and make announcements to that effect. This is a generic power that applies in general, that is, also in relation to where the EBA has examined a competent authority's reasoning in accordance with the second subparagraph of Article 26(3) and considers the relevant instruments not eligible for inclusion in the CET1 list. No indication in the law supports any other reading; on the contrary, recital 74 of the CRR provides an explicit reference to the case in which instruments removed from the list continue to be recognised after the EBA's announcement, and emphasises the possibility of the EBA using its breach of Union law powers under Article 17 of the EBA Regulation, and also the Commission's power to begin infringement procedures.

49. As previously mentioned, the EBA originally focused its work on collecting the list of existing forms of CET1 instruments issued prior to the entry into force of the CRR (before 28 June 2013). These initial instruments were included in the first CET1 list published by the EBA on 28 May 2014<sup>22</sup> and were based purely on the information received from competent authorities.
50. Concerning the types of instruments issued before 28 June 2013, and keeping in mind the provisions of Article 80 of the CRR, the monitoring of the quality of own funds instruments would allow the EBA to evaluate the compliance of these instruments with the eligibility criteria of the CRR in cases in which these instruments are assessed as fully eligible (and not grandfathered) by the competent authorities. Under the provisions of Article 80, significant evidence of CET1 instruments not meeting the eligibility criteria would be notified to the European Commission. In cooperation with competent authorities, the EBA is conducting a review of some of these pre-CRR instruments. It has also happened in some cases that the EBA was requested to assess some pre-CRR instruments.
51. At a second stage, new forms of CET1 instruments were issued by EU institutions after 28 June 2013. On the basis of an assessment provided in the first place by the relevant competent authority (see also section 3.2), the EBA has been assessing on a systematic basis the terms and conditions of all these new forms of CET1 instruments and/or local governing laws and/or statutes of the issuing institutions against the regulatory provisions (as defined in Article 28 or, where applicable, Article 29, complemented by the applicable RTS) to identify provisions governing the instrument that the EBA would see as contradicting the eligibility criteria and with a view to updating the CET1 list. A type of instrument that is judged not to meet the eligibility criteria set out in the CRR and corresponding RTS is not included in the list. This systematic assessment aims to ensure a common EU understanding of the CRR eligibility criteria and a common application of them in practice, with an emphasis in particular on the criteria related to permanence, loss absorption and flexibility of payments.
52. Finally, the inclusion of types of instruments in the list does not necessarily mean that the instrument can be used by all institutions in a given jurisdiction and included in CET1 capital.

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<sup>22</sup> <https://www.eba.europa.eu/-/eba-publishes-list-of-common-equity-tier-1-cet1-capital-instruments>

This may depend, for example, on the nature of the institution, as the eligibility criteria are different for joint stock companies (to which Article 28 would apply) and non-joint stock companies (to which Article 29 would apply). This may also depend on the nature of the instrument, in particular with regard to state aid instruments subscribed by public authorities in emergency situations (see section 3.3).

## 3.2 Process followed

53. In terms of process, in order to (i) facilitate the development of the list at the level of the EBA, (ii) allow the EBA to have the appropriate information to perform future monitoring/assessment of the characteristics of the instruments and (iii) achieve consistency over time, a common format for reporting this information has been designed for use by competent authorities.
54. With regard to new types of instruments (to be) issued, competent authorities are required to provide the necessary adequate information, gathering in particular all the appropriate documentation on the instrument (terms and conditions if any, relevant national laws, bylaws/statutes of the issuing institutions, etc.) required to enable a judgement on whether or not it meets the CRR eligibility criteria, as well as their own assessment of its eligibility in the form of a standard table to be filled in. The prior assessment by competent authorities needs to demonstrate how, in their view, all eligibility criteria of the CRR are met in addition to the provisions of national laws deriving from the applicable corporate laws, for example.
55. All documentation is reviewed by the EBA, throughout the various substructures and up to the level of the EBA Board of Supervisors, which ultimately has to approve all the amendments to the list. In several instances, the EBA has invited the issuing institutions to explain the features of the CET1 instrument, especially where the EBA's initial assessment raised questions with regard to compliance with eligibility criteria. In many cases, several iterations have been necessary, usually leading to some amendments to the features of the new type of instrument, before conclusions were made on its eligibility and inclusion in the list (see also section 4).

## 3.3 State aid versus non-state aid instruments

56. The implication of the inclusion of an instrument in the list also depends on the nature of the instruments as state aid or non-state aid.
57. As explained above, the inclusion of types of instruments in the list to be published does not necessarily mean that the instrument can be used by all institutions in a given jurisdiction and included in their CET1 capital. This applies in particular to state aid instruments subscribed by public authorities in emergency situations (Article 31 of the CRR). These instruments were included for the first time for one jurisdiction (Greece) in the third update of the list published on 8 September 2016, in which a new type of instrument was included.
58. Another new type of instrument was added in the seventh publication of the list (Belgium). Use has been made of Article 31 in the context of the conversion of state-owned preferred shares



previously issued under Article 483 of the CRR, which became ineligible after 31 December 2017. The new instrument resulting from the conversion associates ordinary shares and an additional instrument providing the holder of the converted shares with a preferential distribution in liquidation meant to fulfil the 'burden sharing' requirements of EU state aid rules.

59. When publishing the third update, the EBA has included the following disclaimer with regard to state aid instruments issued under Article 31 of the CRR: 'In the case of capital instruments subscribed by public authorities in emergency situations under Article 31(1) of the CRR, where the relevant competent authority has considered the capital instruments as equivalent to CET1 instruments, and has provided a reasoned request to the EBA, the EBA has included those instruments in the list as CET1 equivalent in accordance with Article 31(2) of that Regulation. However, due to the particular nature of these state aid instruments, their inclusion in the list does not necessarily imply that it would be appropriate to extend specific features or provisions of these capital instruments to other institutions in the relevant Member State.'
60. The CRR requires the EBA to include 'all forms of capital instruments in each Member State that qualify as Common Equity Tier 1 instruments'<sup>23</sup>. The CRR allows the EBA to remove only non-state aid instruments from the list<sup>24</sup>. As a result, state aid instruments are included in the list, on the basis of the relevant competent authority's decision.
61. For all the above reasons, which point to the specificity of the state aid instruments, the EBA deemed it important to identify them separately in specific rows in the list and with a new column, namely column 8, ('Capital instruments subscribed by public authorities in emergency situation as per Article 31 of Regulation (EU) 575/2013') without the need to fill in the cells corresponding to compliance with the provisions of Article 28 or Article 29 of the CRR.
62. This distinction from other CET1 instruments is also deemed necessary by the EBA, because state aid instruments' specific features are not necessarily deemed appropriate to be used automatically or extended to other types of CET1 issuances.
63. Any new potential issuance of state aid instruments would be presented under this format and with the same disclaimer. An exception to this presentation would be made only in the event that state aid would be effected via the use of an existing type of instrument included in the list (such as ordinary shares) and already accepted as fully eligible with regard to the provisions of Article 28 or Article 29 of the CRR.

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<sup>23</sup> See the third subparagraph of Article 26(3) of the CRR. The same wording ('all forms') is also used in recital 74 of the CRR.

<sup>24</sup> See the fourth subparagraph of Article 26(3), which mentions that the 'EBA may, after the review process set out in Article 80 and, where there is significant evidence of those instruments not meeting the criteria set out in Article 28 or, where applicable, Article 29, decide to remove non-State aid capital instruments issued after 28 June 2013 from the list and may make an announcement to that effect.' This seems to imply that state aid instruments issued after the date of entry into force of the CRR are intended to be on the list and may not be removed from it by the EBA.



## 4. Assessment of CET1 issuances — lessons learnt

64. Since the first publication of the list, and based on the information received by each competent authority, the EBA has included 16 new forms of instruments for the following jurisdictions: Finland, Portugal, the United Kingdom (two instruments), Austria (four instruments), the Netherlands, Greece and Belgium (state aid instruments), Germany, Poland, Slovakia and Lithuania (two instruments). Eight of them were issued under Article 29 of the CRR (instruments for mutuals, cooperative societies, savings institutions and similar institutions) and six of them under Article 28 of the CRR. Most of the new forms of instruments were issued with no voting rights. One of them could be issued under either Article 28 or Article 29 of the CRR.

Country	Article of the CRR	Voting rights	In addition to other CET1 instruments	Name of the new form of instrument included	List update
Finland	Art. 29	None	Yes (in addition to cooperative shares)	Non-voting cooperative shares ( <i>Äänivallaton osuus, Andel utan rösträtt</i> )	12/2014
Portugal	Art. 28	None	Yes (in addition to <i>Capital institucional</i> )	Participation units ( <i>Unidades de participação</i> )	12/2014
United Kingdom	Art. 29	Full	No	Deferred share	12/2014
Austria	Art. 29	None	Yes (in addition to cooperative shares)	Instruments without voting rights ( <i>Instrumente ohne Stimmrechte</i> )	10/2015
Netherlands	Art. 29	None	No	Certificates issued by cooperative societies	10/2015

Country	Article of the CRR	Voting rights	In addition to other CET1 instruments	Name of the new form of instrument included	List update
				<i>(Certificaten uitgegeven door een Coöperatie)</i>	
<b>Austria</b>	Art. 28	None	Yes (in addition to ordinary shares)	Instruments without voting rights ( <i>Instrumente ohne Stimmrechte</i> )	09/2016
<b>Greece</b>	Art. 31	None	Yes	Contingent convertible bonds subscribed by the Hellenic Financial Stability Fund  <i>(Υπο αίρεση μετατρέψιμες ομολογίες που έχουν αναληφθεί από το Ταμείο Χρηματοπιστωτικής Σταθερότητας)</i>	09/2016
<b>Poland</b>	Art. 29	Full	No	Membership capital ( <i>Udział członkowski</i> )	12/2016
<b>Austria</b>	Art. 28	None	Yes (in addition to ordinary shares)	Non-voting CET1 instruments <i>(Stimmrechtslose CET1-Instrumente)</i>	05/2017
<b>Austria</b>	Art. 29	None	Yes (in addition to cooperative shares)	Non-voting CET1 instruments <i>(Stimmrechtslose CET1-Instrumente)</i>	05/2017

Country	Article of the CRR	Voting rights	In addition to other CET1 instruments	Name of the new form of instrument included	List update
Germany	Art. 28	None	Yes	Non-voting share in the paid up endowment capital (Stimmrechtsloser Anteil am Stammkapital)	11/2017
Slovakia	Art. 28	Fewer/None	Yes (in addition to ordinary shares)	Preferred share ( <i>Prioritná akcia</i> )	11/2017
Belgium	Art. 31	Full	Yes	Voting ordinary shares ( <i>Actions ou parts assorties d'un droit de vote</i> ) associated with so called contingent liquidation rights	07/2018
United Kingdom	Art. 28	None	Yes (in addition to ordinary shares with full voting rights)	Non-voting ordinary share	07/2019
Lithuania	Art. 29	Full	No	Main share (pagrindinis pajus)	07/2019
Lithuania	Art. 29	None	Yes (in addition to main shares)	Additional share (papildomas pajus)	07/2019



65. The main results of the monitoring and assessment of these new types of instruments are summarised in this section, which is meant not to be too detailed, but rather to highlight areas in which the EBA believed it was necessary to amend the terms and conditions or the national laws or by-laws/statutes to make the new form of instrument eligible as CET1 capital.
66. Out of these 16 new forms of instruments, the EBA requested amendments in several cases. In a few cases, the new form of instruments had already been approved by the competent authority under the applicable legislative framework of the jurisdiction concerned, and the EBA requested amendments so that the instrument could be included in the CET1 list and be eligible as CET1 capital. It is to be noted that, in addition to these 16 new forms, and as mentioned above, in some cases the instrument was not a completely new CET1 form, but a pre-existing non-CRR-compliant instrument, the terms of which had been amended with the aim of ensuring compliance with the new regulatory requirements. The amendments to these terms or variations to the governing laws have necessitated a new assessment of the full provisions of the instrument.
67. The amendments have touched on the following aspects: permanence, loss absorption and flexibility of payments. In particular with regard to instruments issued by cooperative institutions, the EBA scrutinises the potential for the institution to call the instrument, the conditions for the holders to ask for the redemption of the instrument, the amount to be paid to the holder in the event that the instrument is redeemed, and the exercise and rights attached to the various types of voting rights or types of classes of shares and their interactions (as it is not prohibited to have multiple classes of cooperative shares). Overall, the amendments requested by the EBA mainly related to the criterion on the flexibility of payments.
68. It is worth mentioning that some observations may be specific to a given instrument issued by a specific institution and may not be found in other institutions using the same type of instrument. This may be in particular the case where the institution has included in its articles of association some provisions that may relate to a type of instrument that is generally used by several or all institutions in a given jurisdiction because some features of the type of instrument are directly ruled by the national corporate laws. In this latter case, the EBA is conducting surveys, in cooperation with competent authorities that have direct and expert knowledge of the applicable framework in their jurisdictions. The objective is to obtain an EU comprehensive outlook allowing the materiality of any issue detected to be assessed. It is to be noted that the EBA is currently investigating further some interactions between national laws and the CRR requirements in relation to the aspects developed in more detail in the following sections.
69. Finally, as a guiding principle, the EBA believes that complex financial structures could increase the risk of non-compliance with CET1 requirements and that simpler structures may help both the quality and the comparability of CET1 instruments across the Union.

#### 4.1 Use of either Article 28 or Article 29 and appropriate use of the cooperative status

70. Articles 28 and 29 of the CRR contain the eligibility criteria for, respectively, CET1 instruments in

general and more specifically capital instruments issued by mutual, cooperative societies, savings institutions and similar institutions.

71. In addition to the general requirements for own funds contained in the CRR, a specification of conditions under which competent authorities may determine that a type of undertaking recognised under applicable national law qualifies as a mutual, cooperative society, savings institution or similar institution for the purpose of own funds was deemed necessary to mitigate the risk that any institution could operate under the specific status of a mutual, cooperative society, savings institution or similar institution to which specific own funds requirements may apply, whereby the institution does not possess features that are common to the EU cooperative banking sector institutions.
72. The RTS on own funds specifies these conditions for capital purposes. In particular, with respect to CET1 capital, to qualify as a cooperative society, savings institution, mutual or similar institution, the institution shall be able to issue, in accordance with the national applicable law or company statutes, at the level of the legal entity, only capital instruments referred to in Article 29 of the CRR.
73. In one case, the EBA determined that the use of a cooperative structure to issue cooperative shares that could be used to refinance the issuance of ordinary shares by another structure of the same group could be considered a misuse of cooperative status.

## 4.2 Permanence

### **Possibility to refuse redemption (Articles 28(1)(f) and (g) of the CRR)**

74. While publishing its first CET1 report, the EBA assessed a new form of CET1 instrument to be used in a jurisdiction by all cooperative institutions.
75. The instrument existed before the CRR, but local governing laws had to be amended, as the issuing banks were not allowed to refuse the redemption, which was not compliant with CRR/RTS provisions. A first round of amendments to local regulations gave cooperative banks the possibility of deferring or limiting the redemption (as prescribed in Article 10 of Commission Delegated Regulation (EU) No 241/2014), provided that such a possibility was set out in the statutes of a given bank.
76. Nevertheless, the EBA was not satisfied that these changes were giving enough flexibility regarding refusal and redemption (e.g. the local regulation provided only an exhaustive list of cases in which such a limitation would be possible, while the Delegated Regulation did not).
77. Following receipt of the EBA's views, a second round of changes were made to the local law, which were judged satisfactory in a second review by the EBA, as there were no remaining issues that would render the possibility of limiting or deferring the redemption not compliant with the CRR or RTS requirements.
78. Another case of cooperative shares was reviewed by the EBA later. As in the previous case, provisions in the respective local governing law did not provide for the possibility of the

institution to refuse or limit the redemption in the way required by Article 29(2)(b) of the CRR and further specified by Articles 10 and 11 of the RTS on own funds. Corresponding changes in the law granting the institution a right to defer or limit the repayment for an unlimited period of time have been made.

79. The EBA assessed other cases of joint stock companies in which the terms and conditions of the instrument, or the statutes of the institution or side agreements/covenants, provide the possibility for the institution to buy back/redeem its own shares in certain specified situations, for example if the shares are held by employees who have decided to leave the institution.
80. Moreover, the EBA has observed that some national company laws foresee, in a general manner for all types of companies, provisions that may provide a right for redemption of own shares in specific circumstances. The EBA has assessed the interaction of such provisions in national laws with CRR provisions on requirements for CET1 eligibility relating to permanence.
81. In this regard, it needs to be recalled that CET1 instruments are perpetual (Article 28(1)(e) of the CRR) and that the provisions governing the instruments do not indicate expressly or implicitly that the principal amount of the instruments would or might be reduced or repaid other than in the liquidation of the institution, and the institution does not otherwise provide such an indication (Article 28(1)(g) of the CRR). The principal amount of the instruments may not be reduced or repaid except in the cases referred to in Article 28(1)(f) of the CRR, that is, in the case of liquidation and discretionary repurchases or other discretionary means of reducing capital, when the institution has received prior supervisory permission according to Article 77 of the CRR.
82. As a consequence, cases of potential buybacks or redemption of shares, as described above, should be approached under the principle of CET1 capital being permanent and the guiding principles underlying Article 28(1)(f)(ii) of the CRR.
83. In any case, even when the national laws envisage a right of shareholders to redemption, Articles 77 and 78 of the CRR apply. The possibility of the institution redeeming/repurchasing its own shares under such circumstances is then subject to prior supervisory approval. Competent authorities may decide to enhance clarity on the interaction between those national laws and the CRR requirement for CET1 eligibility criteria relating to permanence. They may, for example, request that institutions provide for cross references from the provisions of Articles of Associations, covering redemption of shares to Articles 77 and 78 of the CRR. While such articles will remain applicable nonetheless, this could strengthen the knowledge of the shareholders that their right of redemption could be limited or refused.
84. In one case considered by the EBA, the national corporate law foresaw a right of exit due to the failure to pay dividends. In the event that the general assembly would decline a motion to distribute a predetermined share of the annual profits of the company, any shareholder who voted in favour was given the right to surrender the share to the company. The EBA viewed this as a potential conflict with the CET1 eligibility criteria, with regard to both permanence and flexibility of payments; necessary clarification has been brought in this case and the issue has been resolved.

85. Finally, the EBA investigated the case of 'redeemable shares' for which the share capital is equally split among 10 classes of shares following an alphabetical share structure, each shareholder holding at all times the same proportion in each class (stapling mechanism) with all classes of shares having the same voting rights.
86. The redemption and cancellation of the different categories of shares is to be made, with the prior approval of the competent authority, pursuant to a decision of the 'sole shareholder' or of the general assembly, following a predetermined order (reverse alphabetical order, starting with the last class in the alphabet).
87. These redemption and cancellation possibilities have been assessed as not compliant with the requirements on permanence set out in Article 28(1)(g) of the CRR (see paragraph 81). As the assessment of the instrument also revealed issues with the flexibility of payments in particular (see section 4.4), this new form of instrument was not included in the CET1 list and the issuer has decided to replace the planned structure with an issuance of ordinary shares.

#### **Duration of the company and maturity of the instruments (Article 28(1)(e) of the CRR)**

88. Although in several Member States it is possible for an institution to have a set/defined duration, such a possibility is in practice rather limited. When it exists, the set/defined duration of the institution is fixed either via national legislation or via articles of association. This duration may be extended. This may raise the question of the maturity of the CET1 instruments, which need to be perpetual.
89. In practice, no extension of the duration of the company would result in liquidation. On the one hand, automatic rollovers/extensions of duration are not considered similar to perpetual maturity for AT1 instruments, which are of a lower quality than CET1 instruments. On the other hand, it could be argued that it is naturally the case that instruments end with the life of the issuer. There may be little or no sense in providing an indefinite, explicit 'eternal' maturity for capital instruments that would survive the liquidation of the company itself.
90. The EBA's view is that a set duration of the company would be problematic from a prudential perspective only in cases in which the duration of the instrument would be shorter than the duration of the company. Therefore, instruments whose maturity cannot be dissociated from the life of the institution issuing them are deemed to fulfil Article 28(1)(e) of the CRR and can be considered perpetual. It is expected that the duration of the institution would be regularly extended.

### **4.3 Loss absorption**

91. In one case, the EBA required amendments to the provisions of the terms and conditions related to liquidation proceeds, which were based on the pro rata enterprise value 'at the time of the issuance'. This was deemed not prudent, as it meant that there would be no incentive to recapitalise if the existing equity holders were protected. More precisely, the terms and conditions if not changed might have been seen as predetermining a certain value of the share of the liquidation proceeds, which would contradict Article 28(1)(k) of the CRR, which states that

the claim on the residual assets in the event of liquidation is proportionate to the amount of the instruments issued.

92. In another case assessed by the EBA, the institution's articles of association included the possibility to derogate from the proportional absorption of losses, deriving from a possibility included in the national law applicable to public limited companies. The EBA concluded that such provisions would not be compliant with Article 28(1)(i) of the CRR.

93. The EBA also observed that some articles of association of institutions may provide for the possibility of issuing types of instruments other than ordinary shares, such as, redeemable shares and preference shares. In a case in which such instruments would actually be issued, competent authorities will need to assess the provisions ruling these instruments and apply enhanced scrutiny, in particular, to their ranking and interaction with the different layers of capital, CET1 especially.

## 4.4 Flexibility of payments

### Preference in the order of payments (Article 28(1)(h) and 28(4) of the CRR)

94. It must be recalled that, according to Article 28(1)(h) of the CRR, there shall be no preferential distribution treatment regarding the order of distribution payments, including in relation to other CET1 instruments, and the terms governing the instruments shall not provide preferential rights to payment of distributions. In addition, differentiated distributions shall reflect differentiated voting rights only in accordance with Article 28(4) of the CRR. In this respect, higher distributions shall apply only to CET1 instruments with fewer or no voting rights.

95. In one case assessed by the EBA, a second class of shares was getting a distribution before the first class of shares got any distribution. This type of priority preference is prohibited under the CRR as well as under the RTS on own funds (part 4) on multiple dividends.

96. What is done in practice, in particular, if at the end, both categories of shares received the same amount of distribution over the past year, is irrelevant. It does not matter if the preference is not reflected in effective payments, as there would be no certainty about the flexibility of payments for the future. Following receipt of the EBA's view, the issuing bank amended its articles of association to remove the priority preference.

97. In another case assessed by the EBA, the profits were allocated among different classes of shares based on different percentages of the nominal value of each class of shares up to the last class of shares in existence, which got the residual value of the net profits. In addition, the profits were allocated and paid following a precise order of the different classes of shares. In assessing this case, the EBA considered some arguments from the institution that preferential distributions should exist only when holders of CET1 instruments are at an advantage compared with other holders of CET1 instruments in the same institution. In the case under scrutiny, this was not the case according to the institution, as each shareholder was holding the same percentage of each class of shares.



98. The EBA took the view that the existing order in the distributions and the allocation of profits on the basis of the nominal value of the shares were contrary to the provisions of Article 28(1)(h)(i), 28(1)(h)(iii) and 28(1)(h)(iv) of the CRR relating to the absence of order in the payment of distributions, the absence of a cap or other restrictions and the absence of determination of a distribution on the basis of the issuance price of the instrument. The attribution of a different percentage of the nominal value to the different classes of shares, leading to different amounts to be distributed, is contrary to Article 28(4) and the corresponding RTS on own funds (part 4) on multiple dividends, as all shares in the assessed case had the same voting rights.
99. It was also established that the regulatory provisions should be assessed with regard to the features of the instruments themselves (approach followed in the CRR) and not by reference to their holders' situation.
100. The EBA has also observed that, in some cases, different existing categories of shares present different nominal values. This may create some issues with regard to the application of the RTS on own funds (part 4) on multiple dividends when the nominal value of the preferred share is different from the nominal value of the ordinary share for joint stock companies, as the RTS presupposes that the nominal values of the voting and non-voting shares are the same for the calculation of the multiple dividend for this type of company.

#### **Obligation to pay minimum dividends**

101. Moreover, the EBA assessed several cases in which pre-CRR instruments included in the CET1 list were subject to provisions of national corporate laws, creating either an explicit or implicit obligation to pay minimum dividends to the holders of the instruments under specific circumstances.
102. It is recalled that Article 28(1)(h)(v) of the CRR requires that 'the conditions governing the instruments do not include any obligation for the institution to make distributions to their holders and the institution is not otherwise subject to such an obligation'. This article is meant to ensure the full flexibility of distributions with regard to CET1 instruments.
103. With this in mind, and in cooperation with the competent authorities and with their knowledge and expertise of the applicable framework, the EBA invited the concerned jurisdictions to provide a clarification that, in such cases, the CRR prevails over provisions in the national law where an instrument is counted as regulatory capital. To do so, jurisdictions may clarify this by determining that the obligation to pay a minimum dividend does not apply to CET1 instruments of institutions that are subject to the prudential requirements specified in the CRR, or may request concerned institutions in their jurisdictions to suspend/exclude minimum dividends in the institutions' Articles of Association, if such possibility is provided by the national law.

#### **Loyalty shares (Article 28(4) of the CRR)**

104. The EBA discussed two cases of 'loyalty shares', which are usually ordinary shares with:

- either increased dividend for each share owned by the same person for a continuous period of at least [xx] equal to [xx] per cent of the total dividend distributed to other shares; this right is granted to each shareholder up to [xx] per cent of the capital of the company; or
- increased voting rights for each share owned by the same person for a continuous period of at least [xx] months ([xx] votes rather than one).

105. With regard to the first bullet point above, the holder of an ordinary share may be entitled to benefit from the right to a dividend increase, within a certain limit in terms of percentage of the ordinary dividend, provided that the shareholder has held his or her shares on a continuous basis for a minimum number of years. A second limitation usually applies to the maximum number of shares eligible for a dividend increase per shareholder in terms of percentage of the share capital. The increased dividend corresponds to a loyalty premium, established to encourage and enhance the loyalty of shareholders. With the exception of the potential loyalty premium, all ordinary shares have identical features and give their holders the same rights and obligations and constitute only one category of shares, in particular all ordinary shares (both those that benefit from an increased dividend and those that do not) confer the same voting rights on their holders.

106. With regard to the second bullet point above, the holder of an ordinary share may be entitled to benefit from the right to increased voting rights (e.g. double voting rights), provided that the shareholder has held his or her shares on a continuous basis for a minimum number of years. A limitation may apply to the maximum number of voting rights that a single shareholder may have in the general assembly compared with all existing voting rights. The increased voting rights aims to incentivise long-term holding of capital instruments and the stability of the shareholding base. With the exception of the potential increased voting rights, all ordinary shares have identical features and give their holders the same rights and obligations and constitute only one category of shares; in particular, all ordinary shares (both those that benefit from an increased voting right and those that do not) confer the same dividends on their holders.

107. In conclusion, the EBA takes the following view of the characteristics of these shares:

- For the part described in the first bullet point of paragraph 103 (increased dividends), the characteristics of the shares do not meet the provisions of Article 28(4) of the CRR stating that differentiated distributions shall reflect only differentiated voting rights. In this respect, higher distributions shall apply only to CET1 instruments with fewer or no voting rights, meaning that the dividend increase shall be matched by a limitation in the voting rights. In addition, in prudential terms, the potential existence of a loyalty premium for some existing ordinary shareholders may be seen as a barrier to recapitalisation and to the entry of new shareholders in the capital of the institution if needed.
- For the part described in the second bullet point of paragraph 103 (increased voting rights), several aspects have to be considered:
  - On the one hand, the increased voting rights aims to incentivise

long-term holding of capital instruments and the stability of the shareholding base. In addition, the CRR provisions do not explicitly prohibit increased voting rights, while it could be argued that the increased voting rights are limited by the statutes and do not really bring a disputable advantage to the shareholders concerned, contrary to increased dividends. It could also be judged unlikely that the 'loyalty' shareholders keep the shares in a crisis situation, despite their double voting right feature. The increased voting rights may also be viewed more as an issue related to the governance of the institution and with regard to the rules on qualifying holdings.

- On the other hand, increased voting rights may be assessed in the same way as increased dividends in the sense that they may hinder recapitalisation when needed. This could be the case in particular if a few single shareholders hold an important proportion of shares with increased voting rights, as there does not seem to be a limit in terms of the percentage of loyalty shares with increased voting rights in reference to total capital.

All in all, in the absence of explicit prohibition under the CRR provisions, loyalty shares with increased voting rights may be considered eligible CET1 instruments. That said, based on the considerations above, the EBA deems it necessary for institutions to exercise caution in using the feature of increased voting rights for loyalty shares, as this may create issues in the context of recapitalisation and governance. In addition, competent authorities may also increase the level of scrutiny of these aspects from a qualifying holding perspective.

### **Cancellation of distributions imposing no restriction on the institution (Article 28(1)(h)(vii) of the CRR)**

108. The EBA investigated the situation of an instrument included in the CET1 list in which, in the event that the institution does not declare an annual dividend on the CET1 instrument, it will cancel some of the interest payments on AT1 instruments. Even though in the case investigated no distribution was paid on any of the instruments because of the absence of profits, this provision was assessed by the EBA as not compliant with Article 28(1)(h)(vii) of the CRR, which states that 'the cancellation of distributions imposes no restriction on the institution' (no dividend stoppers or pushers).

### **Distribution policies**

109. The EBA takes the view that it is not appropriate to include indications of distribution policies in the terms and conditions of the instruments, in order not to undermine the full flexibility of payments. It may be acceptable, if the wording is appropriate, that a reference to the dividend policy is included elsewhere (prospectus, press release, dividend policy on the website), so that it can easily be changed. Even in that case, the dividend policy, especially if it includes targeted

dividend pay-outs, should make clear that the targets are not binding at all and can be changed at any time, to pay more, or less, or nothing at all, in order not to contradict the terms and conditions of the instrument.

110. In addition, there should be no inclusion of gross-up clauses for CET1 instruments in case payments thereon become subject to a withholding tax. This is counter-intuitive for a CET1 instrument and may create the expectation that dividends will be paid as and when the gross-up obligation arises, and for that reason they should be avoided.

### **Reinstatement of voting rights to non-voting shares in the absence of dividends (Article 28(1)(h) and 28(4) of the CRR)**

111. The EBA has discussed four cases related to the acceptability of the reinstatement of the voting rights in the absence of dividends.
112. In one case, the instrument (a non-voting instrument with multiple dividends) was not a new one, but an old issuance that had to be restructured in order to become CRR compliant. The contractual provision stated that, if a multiple is not (fully) paid for a fiscal year, the voting rights of the instrument shall be 'reinstated' until such time as a year's multiple is fully paid. In another case, under a similar mechanism, when a dividend is not paid out on the non-voting shares, the shareholder gains voting rights until the day when the general assembly decides on a distribution of the preferred dividend.
113. In other cases, the reinstatement of voting rights had been authorised in the context of a national governing law. In these specific cases, institutions were willing to use these new legal provisions to issue non-voting instruments with multiple dividends in order to be CRR compliant. It has to be noted that in these cases the proportion of non-voting shares would be quite significant compared with the combined total of voting and non-voting shares, even if the national governing law limits the issuance of non-voting instruments to 50% of the share capital. Under certain circumstances, this could lead to a change in the majority in votes at the general assembly, thus providing an incentive to current voting shareholders to pay the multiple dividends.
114. The provision relating to the reinstatement of voting rights when no distributions were made was assessed with reference to the CRR provisions that (i) lay down that cancellation of distribution shall not impose any restriction on the institution (Article 28(1)(h)(v)) and (ii) allow that multiple dividends shall only reflect reduced voting rights (Article 28(4)). With regard in particular to (ii) a provision for the reinstatement of voting rights to compensate for the absence/reduction of distributions, this is not provided for under the CRR. While multiple dividends shall reflect only the absence/reduction of voting rights, the reverse does not apply.
115. On the basis of (i) and (ii) above, the EBA concluded that a reinstatement of voting rights in the absence of dividends would not be in line with the CRR provisions.

### **Covenants/side agreements**

116. The EBA assessed a CET1 instrument without voting rights and with a dividend multiple. The instrument existed before the CRR and was classified as AT1 capital but was restructured to

remove in particular a previous obligation to pay fixed distributions, so as to qualify as CET1 capital. The case under review was particularly complex, as several entities of the same group (including the bank itself) were integrated in a corporate structure in which different parties had different capital participations and voting rights.

117. It appeared that a swap agreement had been put in place between the ultimate voting shareholders and the non-voting shareholder of the bank and that, while the bank was not directly part of it, it was nevertheless aware of it. The effect of the swap agreement was to warrant that all parties remained in the same position economically as they were previously with the old capital instrument, in order to ensure a certain level of distribution from the bank to the shareholders.
118. The EBA took the view that maintaining the benefits of an instrument that has in its original form been phased out from AT1 capital because of the CRR rules should not lead to recognition of a higher form of capital, in particular if the full flexibility of payments, which is a key feature to qualify as CET1, is not ensured. The existence of the swap agreement was considered to provide an incentive to pay dividends and create an additional preference for non-voting shareholders, which may be seen as contradicting the EBA RTS on own funds (part 4) on multiple dividends. Finally, even if formally the quantitative limits of the RTS seem to be respected, the swap agreement could create an additional drag on capital, as it has the effect of increasing the amount of dividends or pressuring the bank to pay dividends in the first place.
119. It was concluded that the capital instrument, together with the conditions governing it and in particular the linked swap agreement, was not eligible for classification as a CET1 instrument, as it does not fulfil the conditions for distributions that are laid down in Article 28(1)(h) of the CRR and is seen as potentially creating an additional drag on capital. As long as the swap agreement was in place, the instrument could not be included in the CET1 list.
120. The EBA assessed a similar case in which promissory notes, separate from the ordinary shares, had been issued by an intermediate holding company to its parent, creating a legal obligation for the intermediate holding company to make payments at some point in the future. This is deemed to undermine the provisions of Article 28(1)(h)(v) of the CRR, which states that the conditions governing the instruments do not include any obligation for the institution to make distributions to their holders and that the institution is not otherwise subject to such an obligation.
121. More generally, the EBA considers that covenants/side agreements or contracts have to be carefully assessed in conjunction with the main terms and conditions of the issuance, so that the overall substance of the instrument/transaction is captured. The eligibility of the instrument should not be assessed on an isolated basis, but as part of the wider transaction(s). A similar recommendation had already been made in the context of the AT1 monitoring report. Here, it is also worth mentioning that CRR2, in accordance with the proposal for an anti-circumvention principle as presented in the EBA 'Opinion on own funds' in the context of the CRR review published on 23 May 2017, introduces a new Article 79a, which requires institutions while assessing instruments' compliance with CRR eligibility criteria, to have regard to all



arrangements related to the instruments, even when they are not explicitly set out in the terms and conditions of the instruments themselves.

### **Distributions in a form other than cash**

122. The EBA has also considered the company laws and Articles of Association of institutions in various jurisdictions, as they relate to provisions recognising the possibility of distributions being made in a form other than cash. The EBA recommends that, where such provisions are included in the Articles of Association, clear references to such distributions being subject to the competent authority's prior permission in accordance with Article 73(1) and subject to the conditions of Article 73(2) of the CRR be added.

## 5. Others — Q&As

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123. It has to be recalled that, in addition to and independently of the assessment of CET1 issuances and the publication of the CET1 list, the EBA regularly publishes Q&As related to CET1 instruments or items. These Q&As can be found on the Interactive Single Rulebook web page<sup>25</sup> on the EBA's website.

124. There are a number of those Q&As that relate in particular to Article 28 or Article 29 of the CRR and to the regulatory provisions on the flexibility of payments:

- [Q&A 2013 541](#): eligibility of capital instruments for classification as CET1 instruments when the instruments are supplemented by a contractual obligation of the majority shareholder to pay a fixed yearly compensation to the minority shareholders
- [Q&A 2017 3636](#): definition of 'paid-up' according to Article 28(1)( b) of the CRR

125. In addition, a significant number of Q&As also give further guidance to stakeholders on the conditions of eligibility of CET1 items, including the following:

- [Q&A 2013 8](#): direct/indirect funding of own shares
- [Q&A 2015 1895](#), [Q&A 2013 24](#) and [Q&A 2016 2808](#): share premium accounts

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<sup>25</sup> <https://www.eba.europa.eu/regulation-and-policy/single-rulebook/interactive-single-rulebook>

## 6. Annex: Legal references<sup>26</sup>

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### Recital 74 of the CRR:

It is appropriate that EBA keeps an up-to-date list of all of the forms of capital instruments in each Member State that qualify as Common Equity Tier 1 instruments. EBA should remove from that list non-State aid instruments issued after the date of entry into force of this Regulation not meeting the criteria specified in this Regulation and should publicly announce such removal. Where instruments removed by EBA from the list continue to be recognised after EBA's announcement, EBA should fully exercise its powers, in particular those conferred by Article 17 of Regulation (EU) No 1093/2010 concerning breaches of Union law. It is recalled that a three-step mechanism applies for a proportionate response to instances of incorrect or insufficient application of Union law, whereby, as a first step, EBA is empowered to investigate alleged incorrect or insufficient application of Union law obligations by national authorities in their supervisory practice, concluded by a recommendation. Second, where the competent national authority does not follow the recommendation, the Commission is empowered to issue a formal opinion taking into account the EBA's recommendation, requiring the competent authority to take the actions necessary to ensure compliance with Union law. Third, to overcome exceptional situations of persistent inaction by the competent authority concerned, the EBA is empowered, as a last resort, to adopt decisions addressed to individual financial institutions. Moreover, it is recalled that, under Article 258 TFEU, where the Commission considers that a Member State has failed to fulfil an obligation under the Treaties, it has the power to bring the matter before the Court of Justice of the European Union.

### Article 26(3) of the CRR:

Competent authorities shall evaluate whether issuances of Common Equity Tier 1 instruments meet the criteria set out in Article 28 or, where applicable, Article 29. With respect to issuances after 28 June 2013, institutions shall classify capital instruments as Common Equity Tier 1 instruments only after permission is granted by the competent authorities, which may consult EBA.

For capital instruments, with the exception of State aid, that are approved as eligible for classification as Common Equity Tier 1 instruments by the competent authority but where, in the opinion of EBA, the compliance with the criteria in Article 28 or, where applicable, Article 29, is materially complex to ascertain, the competent authorities shall explain their reasoning to EBA.

On the basis of information from each competent authority, EBA shall establish, maintain and publish a list of all the forms of capital instruments in each Member State that qualify as Common Equity Tier 1 instruments. EBA shall establish that list and publish it by 28 July 2013 for the first time.

EBA may, after the review process set out in Article 80 and, where there is significant evidence of

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<sup>26</sup> The assessments and/or findings included in this report are based on the eligibility criteria applicable at the time of the review, before the introduction of the amendments to the CRR provisions set out by the CRR2. Consequently, the legal references included in section 6 of this report still concern the CRR, instead of CRR2.



those instruments not meeting the criteria set out in Article 28, or where applicable, Article 29, decide to remove non-State aid capital instruments issued after 28 June 2013 from the list and may make an announcement to that effect.

#### Article 31 of the CRR:

1. In emergency situations, competent authorities may permit institutions to include in Common Equity Tier 1 capital instruments that comply at least with the conditions laid down in points (b) to (e) of Article 28(1) where all the following conditions are met:

- (a) the capital instruments are issued after 1 January 2014;
- (b) the capital instruments are considered State aid by the Commission;
- (c) the capital instruments are issued within the context of recapitalisation measures pursuant to State aid- rules existing at the time;
- (d) the capital instruments are fully subscribed and held by the State or a relevant public authority or public-owned entity;
- (e) the capital instruments are able to absorb losses;
- (f) except for the capital instruments referred to in Article 27, in the event of liquidation, the capital instruments entitle their owners to a claim on the residual assets of the institution after the payment of all senior claims;
- (g) there are adequate exit mechanisms of the State or, where applicable, a relevant public authority or public-owned entity;
- (h) the competent authority has granted its prior permission and has published its decision together with an explanation of that decision.

2. Upon reasoned request by and in cooperation with the relevant competent authority, EBA shall consider the capital instruments referred to in paragraph 1 [Capital instruments subscribed by public authorities in emergency situations] as equivalent to Common Equity Tier 1 instruments for the purposes of this Regulation.

#### Article 80(1) of the CRR:

EBA shall monitor the quality of own funds instruments issued by institutions across the Union and shall notify the Commission immediately where there is significant evidence of those instruments not meeting the criteria set out in Article 28 or, where applicable Article 29.

Competent authorities shall, without delay, upon request by EBA, forward all information that EBA deems relevant concerning new capital instruments issued in order to enable EBA to monitor the quality of own funds instruments issued by institutions across the Union.

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