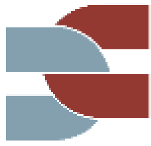

EUROPEAN ASSOCIATION OF CO-OPERATIVE BANKS
The Co-operative Difference : Sustainability, Proximity, Governance

50th
Anniversary
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EACB comments on EBA Draft Regulatory Technical Standards on own funds and eligible liabilities (EBA/CP/2020/05)

General comments

The EACB welcomes the opportunity to comment on the draft EBA RTS own funds and eligible liabilities amending Delegated Regulation (EU) 241/2014 (RTS own funds).

We appreciate that the EBA maintained unchanged, including the 2% threshold for prior permissions, the mechanism for redemption of capital instruments of cooperative banks and mutuals, as it recognized also by supervisors to be working well and being well tailored to specificities of cooperatives and mutuals.

We also appreciate the aim to seek to minimize administrative burden and ensure a framework that is clear overall. However, we are concerned about the proposed introduction of identical requirements for own funds and eligible liabilities without any consideration for the inherent differences of the instruments and their respective functions. We also would stress that particularly in terms of scope a number of adjustments would be especially needed.

Considering the different respective preconditions and functions of own funds and eligible liabilities instruments, we find that the proposed identical requirements would be unsuitable and, causing operational concerns and affecting the funding and resolvability of institutions. The purpose of liabilities held for the fulfilment of MREL requirements is ultimately to ensure resolvability, while the own funds of an institution are intended to ensure financial stability and resilience both for the institutions and the financial system as a whole. This being so, they have fundamentally different maturities and also attract different kinds of investors.

Beside MREL requirements, preferred-senior instruments are typically issued also for funding and liquidity management purposes and thus have considerably shorter maturities than the minimum five years for own funds instruments. In addition, issuers need to fulfil the expectations of investors, including a potential wish for early repayment. This means that, for market reasons, the issuer must have full flexibility to manage issuances – as well as repurchases – in order to successfully maintain investor confidence. Against this background, it is obvious that such operational aspects to eligible liabilities instruments should be the exclusive responsibility of the issuers themselves; it is the institutions which has the knowledge needed to assess funding and liquidity needs, investor preferences and the market outlook. Distorting the functioning of the liabilities' market and the ability of institutions to obtain funding from a varied pool of investors would substantially counteract the objective of ensuring resolvability. Should the requirements for eligible liabilities nevertheless come to closely resemble those for own funds, those requirements should in any case be adjusted in order to ensure that the nature and function of, and the market specificities, of eligible liabilities instruments are taken into account.

Scope of permissions

According to the EBA's CP section "Background and rationale" the permission requirements in Article 78a CRR should apply to all MREL eligible liabilities. This clearly appears disproportionate to the aim of the legislator, rather disregarding the content and rationale of the regulation. When applying a teleological interpretation it

is clear that only eligible liabilities actually used to fulfil MREL would need to be subject to the permission regime: for the purpose of complying with MREL it is irrelevant whether further eligible liabilities exist or not. Such eligible liabilities would have no influence on the MREL requirement. The fact that such instruments have a high quality of loss absorbing capacity cannot per se be a cause to include them under the permission regime.

This becomes even more evident where banks meet requirements with own funds only (in particular institutions that would be wound up using normal insolvency proceedings) and the resolution authorities see no need to oblige the institutions to hold such instruments.

Against this background, both the SRB and NRAs came so far, and on the basis of the same Articles of CRR, to the conclusion that it is not justified to apply the permission regime for such institutions. Rather it appears that the permission regime for own funds is mirrored in the CP without giving sufficient attention to the differences with regard to eligible liabilities. This is also the case for proportionality and bureaucratic aspects, also considering the negative effects for resolution authorities whose resources would be overstretched having to permit nearly all changes of the liabilities side of institutions' balance sheet (which could eventually result in longer processes). An extension of the permission regime, which would at worst also include senior-preferred instruments, would also unnecessarily create additional administrative burden for relevant institutions.

In this context, we would also note that the reference that institutions could issue senior instruments without meeting the eligibility criteria is not appropriate for a regulatory or supervisory authority. In case the determination of institutions' profile by the resolution authorities were to change, they would not possess any eligible liabilities, which cannot possibly be a welcome development.

Scope of instruments

Article 77 and Article 78ca CRR2 define the mandate of EBA in order to develop RTS on calling, redeeming, repaying or repurchasing **eligible liabilities instruments**.

Since this provision is imposed by the CRR2 the term "**eligible liabilities instrument**" should be read first in light of the Regulation. While the definitions of CRR2 (Article 4) do not include the term, this is defined in Article 72b which entails the conditions for the qualification of liabilities as **eligible liabilities instruments**:

"Article 72b Eligible liabilities instruments

1. *Liabilities shall qualify as **eligible liabilities instruments**, provided that they comply with the conditions set out **in this Article** and **only to the extent specified in this Article**.*
2. *Liabilities shall qualify as eligible liabilities instruments, provided that all the following conditions are met: […]*

   *(d) the **claim** on the principal amount **of the liabilities** under the provisions governing the instruments **is wholly subordinated** to claims arising from the excluded liabilities referred to in Article 72a(2); that subordination requirement shall be considered to be met in any of the following situations; […]"*

One of the criteria in Article 72b is the subordination requirement, thus if an instrument is not subordinated, the conditions for qualifying as "eligible liabilities instrument" for the purpose of CRR would not be met.

The "subordination" criterion does not include exemption in terms of Article 77 and Article 78b CRR2. Therefore, the term "**eligible liabilities instrument**" covers **only subordinated liabilities**. While there are no other definitions for "eligible liabilities instrument" in CRR, the variations in the BRRD definition do not seem to change the CRR definition. In this vein, the eligible liabilities mentioned in Article 77 (2) and 78a CRR2 are only

subordinated eligible liabilities and therefore **only subordinated liabilities should be included in the scope of the EBA draft RTS**.

Since the EBA is proposing to **extend the scope of the draft RTS in relation to eligible liabilities** and to cover all TLAC and MREL eligible liabilities, the specifications on direct and indirect funding, incentives to redeem and prior permissions are equally applicable to eligible liabilities for TLAC and MREL purposes (see page 9 EBA/CP/2020/05). Hence, according to the draft RTS the permission regime for reducing liabilities applies not only to eligible liabilities as defined in Art 72b CRR II (only subordinated liabilities) but also to eligible liabilities as defined in the BRRD (i.e. also non subordinated liabilities).

This is insofar problematic, as the legal foundation for the permission regime for reducing eligible liabilities instruments and the legal foundation for the EBAs mandate to develop the related draft regulatory standards are both enshrined in the CRR II (as described above). Therefore, the draft regulatory standards should be based on the definitions of the CRR II, and should thus only apply to eligible liabilities as defined in Art 72b CRR II (only subordinated liabilities). **Non-subordinated liabilities should be excluded from the scope of the draft RTS.**

This would also be in line with the **transitional regime installed by NCAs**. Authorities (e.g. Austrian Financial Market Authority, FMA) implemented a transitional regime (applicable until the regulatory standards will enter into force), according to which Art 78a CRR II only applies to subordinated eligible liability instruments and eligible liability instruments with a remaining maturity of less than one year.

- ***Subject of permissions***

It should be made clear in the RTS that prior permission is to be granted for a certain amount up to an amount corresponding to a specific proportion of the institution's total own funds and eligible liabilities. The detailed information requirements, on the contrary, would seem to lead to permission effectively being granted on the basis of individual positions. Granting permissions separately for individual instruments would, especially considering the information required as well as the time limit, severely affect the preconditions for institutions to manage the fulfilment of requirements over time and constitute an additional reporting requirement on top of existing reports. This would be unnecessary considering that in terms of the effects of deductions on the capital situation of an institution, and its resolvability, the holding of an individual instrument is less relevant than the total amount of liabilities held. Thus, allowing competent authorities to grant permission on the basis of certain amounts corresponding to specific proportions of the institutions total eligible liabilities instruments, rather than on the basis of individual instruments, would more closely relate to the objective of ensuring the fulfilment of requirements and ultimately, the resolvability of the institution and act as a safeguard as to the institution's capacity to operate with own funds and eligible liabilities above the amount required following the deductions.

- ***Economic viewpoint***

The proposed strict rules regarding prior permissions in para 14-16 would make it very difficult to recapitalise an institution. Liabilities which are (no longer) eligible for the purpose of MREL should be easily redeemable to allow issuances of eligible liabilities without increasing the total amount of liabilities, and respectively the liquidity position.

Buyback restrictions on existing Senior Bonds would have negative impacts on the secondary market. Consequently, it would make this asset class less attractive for investors, which would lead to higher issuance cost for banks.

- ***Market making and investor perspective***

Against the background of market realities and investors' needs, the proposed four-month deadline, in combination with the requirement to deduct the authorised amount from the moment of granting of authorisation, would severely hamper institutions' market making activities. Institutions would, regardless of investors' needs and market development, be forced to plan all activities, including issuances and deductions, four months in advance, and to execute these immediately from the very moment an authorisation for a deduction has been granted. As a result, the secondary market liquidity of the instruments would be reduced to the extent that their attractiveness from an investor perspective would be considerably affected, something which, in turn, could ultimately also affect the resolvability of institutions.

- ***Entry into force and transitional provisions***

Considering the effects of the four-month deadline, if included in the final RTS, the application date should be extended well beyond the date of entry into force. At the very least, transitional provisions should be included in the RTS in order to smoothen the implementation process and to somewhat minimise the negative effects on the market.

- ***Historical interpretation in the light of TLAC***

According to the FSB Total Loss-absorbing Capacity (TLAC) Term sheet[1], under para. 11 TLAC eligible liabilities must be subordinated. The TLAC term sheet has been used as a blueprint for provisions in BRRD2 (and CRR2, albeit the implementation of TLAC itself is for G-SIIs and to a lesser extent for top-tier banks).

As TLAC only addresses subordinated eligible liabilities, we believe the EBA would be gold-plating by extending the scope of Article 77 and Article 78a CRR2 to all eligible liabilities in general and a significant competitive disadvantage compared to non-EU countries.

- ***Eligible liabilities for internal TLAC/MREL***

Internal MREL can be complied with by issuing internal MREL eligible liabilities or by granting internal guarantees if the conditions in Article 45f (5) BRRD2 are met. The title of Article 78a CRR2 is "Permission to reduce eligible liabilities instruments". Therefore, guarantees are not within the scope of Article 78a CRR2. It would not be consistent to treat all internal MREL eligible liabilities the same strict way as own funds, in fact equivalent guarantees can be withdrawn or reduced without any limitation.

- **Eligible liabilities which "do not meet the one year maturity requirement anymore"**

As "*a remaining maturity of at least one year*" is a condition that liabilities must meet in order to be MREL eligible, it seems rather inconsistent to demand prior permission to reduce liabilities that do not meet such criterion. We understand that the EBA is particularly looking forward to comments on the adequacy of the reduction process for non-subordinated eligible liabilities and on the overall flexibility of the proposed regime for eligible liabilities that are not subordinated and that have a maturity that would not qualify them as eligible liabilities (i.e. < 1 year). We believe that in light of the elements outlined above, the proposed process is unduly bureaucratic and rather hampering the regular process of issuances and replacement of debt instruments.

Answers to specific questions

Question 1: What is the percentage of senior non-preferred and senior preferred liabilities in relation to total liabilities for the institution(s) you represent? Within the senior-preferred layer, what is the percentage of eligible to non-eligible liabilities for this/these institution(s)?

The CRR2 introduces new granular eligibility criteria for eligible liabilities related, inter alia, to acceleration, set-off and netting, reference to write down and conversion etc. and the requirement that the instrument be

[1] https://www.fsb.org/wp-content/uploads/TLAC-Principles-and-Term-Sheet-for-publication-final.pdf

subject to permission. However, some of these criteria are grandfathered indefinitely for existing instruments (legacy instruments) under Article 72b(2)(n) or Article 494b(3) CRR.

NA

Question 2: What is the quantitative significance and maturity distribution, for the institution(s) you represent, of unsubordinated instruments that are eligible liabilities solely as a result of the grandfathering provisions under Article 72b(2)(n) or Article 494b(3) of the CRR, compared to unsubordinated instruments qualifying under their own right as MREL, total MREL eligible liabilities and total liabilities? Do these instruments contain call options?

NA

Question 3: Once the stock of legacy instruments described above is exhausted, instruments will only be eligible to MREL if they meet all eligibility criteria, including the new criteria. Do you expect that, as a result, going forward the amount of eligible liabilities as a share of senior instruments, would be narrowed concomitantly with the scope of the permission requirement?

NA

Question 4: It is recalled that, as per the mandate to the EBA, the RTS on eligible liabilities for the purpose of indirect funding has to be fully aligned with the one on own funds. Are the interactions and consequences of the rules on direct and indirect funding appropriately described and captured for eligible liabilities and resolution groups?

NA

Question 5: Would you agree that the existing percentage values for the thresholds are still suitable? If not please provide evidence and rationale for having different values.

NA

Question 6: Do you consider that the general prior permission as per the 2nd subparagraph of Article 78(1) CRR, with the limits included therein, would be sufficient to cater for permissions to repurchase own funds instruments then to be passed on to employees as part of their remuneration (former Article 29(4) of the RTS), in addition to market making and other repurchase activities? Would you consider any derogations to be needed (in particular in terms of limits and one-year timeframe)?

NA

Question 7: Do you agree that the provision regarding permission for immaterial amounts to be called, redeemed or repurchased (former Article 29(5) of the RTS) is no longer needed? If you disagree please provide a substantiated rationale.

NA

Question 8: Is the information required appropriate? Please specify any change you would make and why. Please consider consistency with the prior permission regime for eligible liabilities instruments.

Considering the relatively short one-year validity period for granted permissions and the fact that based on Article 32d(1)(d) and 32e(1)(a) of the RTS, permission would seem to – possibly – be granted separately for individual instruments, the information requirement is overly extensive. Also, a large amount of this information should already be available for both resolution and supervisory authorities through the existing MREL and COREP reporting. Imposing additional reporting requirements concerning the same information would thus constitute unnecessary increase in the reporting burden of the institutions, in effect a duplication in the collection of data which the two authorities, through a memorandum of understanding, have agreed to avoid. Not only is the requirement a duplication of reporting requirements, it is also unnecessary considering that in terms of the effects of deductions on the capital situation of an institution, and its resolvability, the holding of an individual instrument is less relevant than the total amount of liabilities held.

Question 9: Do you consider the four months deadline appropriate? Would you consider making a difference between the individual permissions pursuant to Article 78(1) points (a) or (b) CRR and the general prior permission pursuant to the 2nd subparagraph of Article 78(1) CRR? In case the four months deadline was kept for first time applications for general prior permission, would you see merit in:

a) shortening the deadline for applications for the renewal of the permission?

b) adjusting the content of the application to be submitted to the competent authority?

Please provide some rationale. Also, please consider consistency with the prior permission regime for eligible liabilities instruments.

With regard to eligible liabilities the period of four months is not feasible and reasonable. The issuances concerned comprise very large volumes and are broadly diversified in terms of content and include retail. Therefore, we advocate for refining the time period regarding eligible liabilities to a one-month period.

Against the background of market realities and investors' needs, the proposed four-month deadline, in combination with the requirement to deduct the authorised amount from the moment of granting of authorisation, would severely hamper institutions' market making activities. Institutions would, regardless of investors' needs and market development, be forced to plan all activities, including issuances and deductions, four months in advance, and to execute these immediately from the very moment an authorisation for a deduction has been granted. As a result, the secondary market liquidity of the instruments would be reduced to the extent that their attractiveness from an investor perspective would be considerably affected, something which, in turn, could ultimately also affect the resolvability of institutions.

Question 10: It is recalled that, as per the mandate to the EBA, the RTS on eligible liabilities for the purpose of specifying the meaning of sustainable for the income capacity of the institution has to be fully aligned with the one on own funds. Do you see any unintended consequences stemming from the drafting of Article 32a?

Establishing the same mechanism for own funds also for eligible liabilities creates a disproportionate burden for banks, as eligible liabilities, unlike own funds, do not absorb losses in a business-as-usual or even a crisis situation but only in the extreme case of a resolution. Thus, mandating RAs to assess any reduction with a view on the long-term profitability rather appears like goldplating. Also, the assessment by the resolution authorities is not well defined, leaving room for interpretation and uncertainty.

Q11. Do you consider the deduction rules appropriate for eligible liabilities? If not, what would be the rationale for departing from the rules applicable for own funds?

As far as we understand, CRR 2 does not provide a legal basis for a deduction at the time of granting the authorization by the resolution authority. The proposed RTS Art. 31 para. 3 would result in massive damage to the liquidity of the instrument and thus lead to increases in price. However, such instruments should be as liquid as possible. Therefore, we advocate for amending para. 3 as any deduction should be made at the time of the repurchase only and not the time of e.g. authorization.

With regard to institutions with MREL decisions not higher than the loss absorption amount, in particular institutions that would be wound up under normal insolvency proceedings (if they were to be included in the permission regime for eligible liabilities – provided that we do not support such proposal), the deduction rules are not appropriate. Such institutions would have to deduct eligible liabilities, which – according to the determination of the resolution authorities – they do not need for MREL or resolution purposes from their own funds and would be, put at a disadvantage a second time in addition to the unnecessary permission regime.

Furthermore, at a general level, deducting eligible liabilities at the point of receiving permission is disproportionate. The purpose of MREL is to have sufficient own funds and eligible liabilities, whose amount is established by the resolution authorities on the basis of a specific calculation mechanism, and to which a dedicated regime for handling breaches is applied. The introduction of the M-MDA under the 2019 Banking Package and the fact that of own funds used for buffer requirements are not eligible for MREL, act as safeguards and ensure that sufficient capacity for loss-absorption and recapitalization is available at all times. The deductions not only ignore the different qualities and riskiness of the instruments in question (CET1, AT1 and T2 instruments as the first instruments classes to bear losses vs. eligible liabilities that are senior in nature and rank above all own funds) but also make the complex bank-specific calculation of MREL and the add-ons, buffers and group-specific adjustments redundant. It is a core task of resolution authorities to set the MREL at a level sufficient to recapitalise a bank (when that is the relevant case). We do not see a need for the EBA to go beyond this and interfere by means of an automatic deduction. Deducting the amounts under the permission regime does not add to the existing safeguards.

Q12. Do you agree that general prior permissions should not be confined only to market making? Why would liability management operations not be sufficiently covered, as for own funds, via ad-hoc permissions? Please substantiate based on concrete experience.

NA

Q13. Is the maximum limit of 3% of the total amount of outstanding eligible liabilities instruments sufficient? If not, please explain which percentage value of outstanding eligible liabilities instruments you would suggest and justify based on your experience.

According to our view the limit of 3% is, at least for institutions with MREL decisions not higher than the loss absorption amount, and in particular institutions with would be wound up using normal insolvency proceedings (if they were to be part of the permission regime for eligible liabilities) not adequate. In such cases the resolution authorities should adopt a general and unquantified prior permission including all potential eligible liabilities (without deduction requirements).

We believe that the 3% limit is not sufficient and should be extended to at least 10% in order to provide more flexibility for the secondary market.

Q14. Would you see some good rationale for exempting certain types of entities from the limits foreseen in Article 32c? Please describe cases and substantiate your rationale.

See our answer to Q13.

Q15. Do you think the information required in Article 32d is appropriate? Please precise any change you would suggest and why. Please consider consistency with the prior permission regime for own funds.

As indicated under Q8, considering the relatively short one-year validity period for granted permissions and the fact that based on Article 32d(1)(d) and 32e(1)(a) of the RTS, permission would seem to – possibly – be granted separately for individual instruments, the information requirement is overly extensive. Also, a large amount of this information should already be available for both resolution and supervisory authorities through the existing MREL and COREP reporting. Imposing additional reporting requirements concerning the same information would thus constitute unnecessary increase in the reporting burden of the institutions, in effect a duplication in the collection of data which the two authorities, through a memorandum of understanding, have agreed to avoid. Not only is the requirement a duplication of reporting requirements, it is also unnecessary considering that in terms of the effects of deductions on the capital situation of an institution, and its resolvability, the holding of an individual instrument is less relevant than the total amount of liabilities held.

Question 16: Do you consider the four months deadline in Article 32f appropriate? Would you consider making a difference between the individual prior permission pursuant to Article 78a(1) points (a), (b) or (c) CRR and the general prior permission pursuant to the 2nd subparagraph of Article 78a(1) CRR? In case the four months deadline was kept for first time applications for general prior permission, would you see merit in:

a) shortening the deadline for applications for the renewal of the permission?

b) adjusting the content of the application to be submitted to the competent authority?

Please provide some rationale. Also, please consider consistency with the prior permission regime for own funds.

As stated under Question 9, the four-month deadline, especially in combination with the one-year validity and the requirement to carry out the deduction upon the granting of authorisation, is neither feasible nor reasonable.

Against the background of market realities and investors' needs, the proposed four-month deadline, in combination with the requirement to deduct the authorised amount from the moment of granting of authorisation, would severely hamper institutions' market making activities. Institutions would, regardless of investors' needs and market development, be forced to plan all activities, including issuances and deductions, four months in advance, and to execute these immediately from the very moment an authorisation for a deduction has been granted. As a result, the secondary market liquidity of the instruments would be reduced to the extent that their attractiveness from an investor perspective would be considerably affected, something which, in turn, could ultimately also affect the resolvability of institutions.

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