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WORKING PAPER

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WORKING DOCUMENT

From:	Presidency
To:	Working Party on Financial Services (Risk Reduction Measures)
Subject:	(REVISED) Own Funds

Delegations will find attached a revised version of the Own Funds non-paper from the Presidency for the RRM Working Party Meeting of 7 & 8 September.

For ease of reference, we are sending a clean document and a version with track changes compared against the initial Own Funds non-paper circulated on 30 August.

7-8 September 2017

Working Party Financial Services (RRM)

OWN FUNDS (REVISED)

Background

The Presidency is circulating this non-paper to discuss the following non-technical or political own funds-related issues at the Working Party meeting of 7/8 September:

i. reinforcement and clarification of the EBA powers in relation to CET1 instruments;

ii. simplification of the process for competent authorities to approve subsequent issues of CET1 instruments;

iii. new grandfathering provision for own funds instruments;

1. EBA powers in connection with CET1 instruments

Pursuant to Article 80 of the CRR, the EBA has been monitoring the quality of CET1 issuances in the EU since 2013. In accordance 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 CET1 list).

According to the EBA's opinion on Own Funds:

"*the monitoring of the CET1 instruments performed by the EBA in the context of the CET1 list has been beneficial in terms of implementation of the CRR and RTS provisions and has also allowed strengthening the quality of capital of EU institutions for newly issued instruments.*

That said, according to current CRR provisions, the responsibility of evaluating whether issuances of CET1 instruments meet the criteria set out in Articles 28 or 29 of the CRR as applicable lies with

competent authorities. This may lead to situations where, while the instrument has already been issued, the EBA may disagree with the evaluation of the competent authority; however, the final say would still be in the hands of the latter".

The EBA recommends "reinforcing" its role with regard to CET1 instruments as a means to ensuring "a harmonised and consistent application of the CET1 eligibility criteria". By virtue of this "reinforced role":

i. competent authorities would be obliged to consult with the EBA on an ex ante basis for new forms or new types of instruments that are not in the CET1 list (not for all issuances);

ii. the EBA would be granted an express power to take either of the following actions: a) not include instruments in the CET1 list and b) remove instruments from the list;

iii. the EBA would be given explicitly the power to request information from competent authorities on instruments issued before the entry into force of the CRR (which have been originally included in the CET1 list with no prior EBA assessment).

Delegations will find attached in Annex I the proposed amendments to the CRR consistent with the EBA recommendations. It is also suggested to include an ad hoc recital to the same effect.

The Presidency kindly invites Delegations to reflect on the "reinforced role" for the EBA in connection with CET1 instrumens as suggested herein.

2. Simplified process for subsequent issuances of CET1 instruments

Article 26(3) of the CRR as currently in force requires competent authorities' prior approval for institutions to begin to classify capital instruments as CET1. It appears unduly burdensome to require the approval of every subsequent issue of capital instruments where these are underpinned by the same legal documentation (eg repetitive issues of instruments under the same programme).

Article 26(3) should, therefore, be amended to require competent authorities' prior approval only for the initial issuance of CET1 instruments. Subsequent issuances would be exempted from this approval provided that they are underpinned by the same or substantially the same legal documentation.

The relevant amendments to the legal text are shown in Annex I.

The Presidency kindly invites Delegations to reflect on the suggested simplified process for subsequent issuances of CET1 instruments.

3. Grandfathering period for AT1 and Tier 2 instruments

As new criteria are introduced for AT1 and Tier 2 instruments requiring a mandatory PONV clause for third country issuances (Art. 52(1)(q) and 63(o)) and prohibiting set-off and netting arrangements (Art. 52(1)(r) and 63(p)), it may be appropriate to provide for a transitional period to give institutions enough time to amend their contractual arrangements to meet the new requiremets.

The proposed transitional period would have the following features:

i. its duration would be three years from 1 January 2019 (the starting date of application for own funds provisions as per Art. 3 of the CRR Proposal);

ii. it would apply to any AT1 and Tier 2 instruments issued before the date of entry into force of the CRR Proposal (Art. 3(1) of the Proposal);

i. it would cease to apply at the latest after the three year period referred to above, such that non-compliant issuances would cease to qualify as AT1 or Tier 2 instruments (non-perpetual nature).

The relevant amendments to the legal text are shown in Annex II.

The Presidency kindly invites Delegations to reflect on the suggested grandfathering period for AT1 and Tier 2 instruments.

ANNEX I

New recital:

(X) it is necessary to provide for a clear and transparent process of approval for Common Equity Tier 1 instruments that can contribute to maintaining the high quality of these instruments. To that end, competent authorities should have the responsibility to approve these instruments before institutions may classify them as Common Equity Tier 1. However, such prior permission should not be required for Common Equity Tier 1 instruments issued on the basis of legal documentation already approved by the competent authority and provided that no substantial changes are made to such documentation. In view of EBA's role to further convergence of supervisory practices and enhance the quality of own funds instruments, competent authorities should consult the EBA before approving any new type of Common Equity Tier 1 instruments. Such consultation with the EBA should not be required for Common Equity Tier 1 instruments with features substantially similar to those of instruments already reviewed and deemed compliant by the EBA".

12a) In Article 26, paragraph 3 is replaced by the following[1]:

"3. Competent authorities shall evaluate whether issuances of ~~**Common Equity Tier 1**~~ capital instruments meet the criteria set out in Article 28 or, where applicable, Article 29. ~~**With respect to issuances after 28 June 2013,**~~ **i**Institutions shall classify capital instruments as Common Equity Tier 1 instruments only after permission is granted by the competent authorities~~**, which may consult the EBA**~~ **.Competent authorities' prior permission as referred hereto shall only be required for the first issuance of Common Equity Tier 1 instruments, provided that no substantial changes are made to the legal documentation for subsequent issuances.**

Competent authorities shall consult the EBA before granting the permission for capital instruments to be classified as Common Equity Tier 1 instruments. Consultation with the EBA shall not be required for capital instruments of the same type as those previously deemed compliant by the EBA. Competent authorities shall have due regard to EBA's opinion and, where they decide to deviate from it, write to EBA within three months from the date of receipt setting out the rationale for deviating from the relevant opinion.

~~For capital instruments, with the exception of State aid, that are aprroved as eligible for classification as Common Equity Tier 1 instruments by the competent authority but where, in the opinion of the EBA, 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 **collected** from each competent authority, EBA shall establish, maintain and publish a list of all **types** ~~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 for the first time**~~

[1] Track changes against par. 3 of Article 26 of the CRR as currently in force.

~~by 28 July 2013.~~ **In accordance with Article 35 of Regulation (EU) No 1093/2010, EBA may collect any information in connection with Common Equity Tier 1 instruments that it deems necessary to establish compliance with the criteria set out in Article 28 or, where applicable 29 and for the purposes of maintaining and updating the list referred hereto.**

~~EBA may, after~~ **Following** the review process set out in Article 80 and where there is ~~significant~~ **sufficient** evidence ~~of~~ **that** ~~those~~ **the relevant capital** instruments **do** not **meet or have ceased to** meet~~ing~~ the criteria set out in Article 28 or, where applicable, Article 29, **EBA may** decide ~~**to remove**~~ not to ~~include~~ **add** ~~**non-State aid capital instruments issued after 28 June 2013 from**~~ or ~~to~~ remove those instruments **to or** from the list**, as the case may be**. ~~**and may**~~ EBA **shall** make an announcement to that effect **that shall also refer to the relevant competent authority's position on the matter.**

This paragraph shall not apply to the capital instruments referred to in Article 31".

ANNEX II

The following Article is inserted after Article XXX (in Part X of CRR)

"Article X

Grandfathering period for Additional Tier 1 and Tier 2 Instruments

1. By way of derogation from Articles 51 and 52 of this Regulation, instruments issued prior to [date of entry into force of CRR 2] shall qualify as Additional Tier 1 instruments until [31 December 2021], where they meet the conditions laid down in Articles 51 and 52, except for the conditions referred to in points (q) and (r) of Article 52.

"2. By way of derogation from Articles 62 and 63, instruments issued prior to [date of entry into force of CRR 2] shall qualify as Tier 2 instruments at the latest until [31 December 2021] where they meet the conditions laid down in Articles 62 and 63, except for the conditions referred to in points (o) and (p) of Article 63".

7-8 September 2017

Working Party Financial Services (RRM)

OWN FUNDS (REVISED)

Background

The Presidency is circulating this non-paper to discuss the following non-technical or political own funds-related issues at the Working Party meeting of 7/8 September:

i. reinforcement and clarification of the EBA powers in relation to CET1 instruments;

ii. simplification of the ~~the issue~~ process for competent authorities to approve subsequent issues of CET1 instruments;

iii. new grandfathering provision for own funds instruments;

1. EBA powers in connection with CET1 instruments

Pursuant to Article 80 of the CRR, the EBA has been monitoring the quality of CET1 issuances in the EU since 2013. In accordance 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 CET1 list).

According to the EBA's opinion on Own Funds:

"*the monitoring of the CET1 instruments performed by the EBA in the context of the CET1 list has been beneficial in terms of implementation of the CRR and RTS provisions and has also allowed strengthening the quality of capital of EU institutions for newly issued instruments.*

That said, according to current CRR provisions, the responsibility of evaluating whether issuances

of CET1 instruments meet the criteria set out in Articles 28 or 29 of the CRR as applicable lies with competent authorities. This may lead to situations where, while the instrument has already been issued, the EBA may disagree with the evaluation of the competent authority; however, the final say would still be in the hands of the latter".

The EBA recommends "reinforcing" its role with regard to CET1 instruments as a means to ensuring "a harmonised and consistent application of the CET1 eligibility criteria". By virtue of this "reinforced role":

i. competent authorities would be obliged to consult with the EBA on an ex ante basis for new forms or new types of instruments that are not in the CET1 list (not for all issuances);

ii. the EBA would be granted an express power to take either of the following actions: a) not include instruments in the CET1 list and b) remove instruments from the list;

iii. the EBA would be given explicitly the power to request information from competent authorities on instruments issued before the entry into force of the CRR (which have been originally included in the CET1 list with no prior EBA assessment).

Delegations will find attached in Annex I the proposed amendments to the CRR consistent with the EBA recommendations. It is also suggested to include an ad hoc recital to the same effect.

The Presidency kindly invites Delegations to reflect on the "reinforced role" for the EBA in connection with CET1 instrumens as suggested herein.

2. Simplified process for subsequent issuances of CET1 instruments

Article 26(3) of the CRR as currently in force requires competent authorities' prior approval for institutions to begin to classify capital instruments as CET1. It appears unduly burdensome to require the approval of every subsequent issue of capital instruments where these are underpinned by the same legal documentation (eg repetitive issues of instruments under the same programme).

Article 26(3) should, therefore, be amended to require competent authorities' prior approval only for the initial issuance of CET1 instruments. Subsequent issuances would be exempted from this approval provided that they are underpinned by the same or substantially the same ~~programme~~ legal documentation.

The relevant amendments to the legal text are shown in Annex I.

The Presidency kindly invites Delegations to reflect on the suggested simplified process for subsequent issuances of CET1 instruments.

3. Grandfathering period for AT1 and Tier 2 instruments

As new criteria are introduced for AT1 and Tier 2 instruments requiring a mandatory ~~clause of~~ PONV clause for third country issuances (Art. 52(1)(q) and 63(o)) and prohibiting set-off and netting arrangements (Art. 52(1)(r) and 63(p)), it may be appropriate to provide for a transitional period to give institutions enough time to amend their contractual arrangements to meet the new requiremets.

The proposed transitional period would have the following features:

i. its duration would be three years from ~~the~~ 1 January 2019 (the starting date of application for own funds provisions as per Art. 3 of the CRR Proposal);

ii. it would apply to any AT1 and Tier 2 instruments issued before the date of entry into force of the CRR Proposal (Art. 3(1) of the Proposal);

i. it would cease to apply at the latest after the three year period referred to above, such that non-compliant~~tee~~ issuances would cease to qualify as AT1 or Tier 2 instruments (non-perpetual nature).

The relevant amendments to the legal text are shown in Annex II.

The Presidency kindly invites Delegations to reflect on the suggested grandfathering period for AT1 and Tier 2 instruments.

ANNEX I

New recital:

(X) it is necessary to provide for a clear and transparent process of approval for Common Equity Tier 1 instruments that can contribute to maintaining the high quality of these instruments. To that end, competent authorities should have the responsibility to approve ~~new issuances of~~ these instruments before institutions may classify them as Common Equity Tier 1. However, such prior permission ~~**approval**~~ **should not be required for ~~subsequent issuances of~~ Common Equity Tier 1 instruments~~, that is, where instruments are issued~~** issued **on the basis of ~~pre-approved~~** legal **documentation** already approved by the competent authority ~~**or as part of the same programme of issuances**~~ **and provided that no substantial changes are made to such documentation. In view of EBA's role to further convergence of supervisory practices and** enhance~~assess~~ **the quality of own funds instruments, competent authorities should consult the EBA before approving any new** type ~~**issuance**~~ **of Common Equity Tier 1 instruments.** ~~**Consistent with the principle set out herein, s**~~**Such consultation with the EBA should not be required for ~~subsequent issuances of~~ Common Equity Tier 1 instruments** with ~~**insofar as the defining**~~ **features ~~of these would be~~ substantially similar to** those of ~~**outstanting**~~ **instruments already reviewed** and deemed compliant **by the EBA".**

12a) In Article 26, paragraph 3 is replaced by the following[1]:

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

Competent authorities' prior permission as referred hereto shall ~~not~~ only be required for the first issuance of Common Equity Tier 1 instruments, provided that no substantial changes are made to the legal documentation for **subsequent issuances**~~**. of instruments**~~

Competent authorities shall consult the EBA before granting the permission for capital instruments to be classified as common equity tier 1 instruments. Consultation with the EBA shall not be required for capital instruments of the same type as those previously deemed compliant by the EBA. ~~**on the basis of pre-approved documentation or as part of the same programme of issuances, provided that no substantial changes are made to the programme documentation**~~**. Competent authorities shall ~~in all cases~~ have due regard to EBA's opinion and, where they decide to deviate from it, write to EBA within three months from the date of receipt setting out the rationale for deviating from the relevant opinion.**

[1] Track changes against par. 3 of Article 26 of the CRR as currently in force.

~~For capital instruments, with the exception of State aid, that are aprroved as eligible for classification as Common Equity Tier 1 instruments by the competent authority but where, in the opinion of the EBA, 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 **collected** from each competent authority, EBA shall establish, maintain and publish a list of all types of ~~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 for the first time by 28 July 2013.**~~ By ~~virtue of~~ In accordance with **Article 35 of Regulation (EU) No 1093/2010, EBA** ~~may~~**shall be entitled to collect any information in connection** with **Common Equity Tier 1 instruments that it deems necessary to establish compliance with the criteria set out in Article 28 or, where applicable 29 and for the purposes of maintaining and updating the list referred hereto.**

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~~**EBA may, after**~~ **Following** the review process set out in Article 80 and where there is ~~significant~~ **sufficient** evidence ~~of~~ **that** ~~those~~ **the relevant capital** instruments **do** not **meet or have ceased to** meet~~ing~~ the criteria set out in Article 28 or, where applicable, Article 29, **EBA may** decide ~~**to remove**~~ not to ~~include~~ **add ~~non-State aid capital instruments issued after 28 June 2013~~ ~~from~~** or ~~to~~ remove those instruments **to or** from the list**, as the case may be**. ~~**and may**~~ EBA **shall** make an announcement to that effect **that shall also refer to the relevant competent authority's position on the matter.**

This paragraph shall not apply to the capital instruments referred to ~~be without prejudice to the provisions laid down~~ **in Article 31**~~" for the classification of capital instruments subscribed by public authorities in emergency situations as Common Equity Tier 1 instruments"~~**.**

ANNEX II

The following Article is inserted after Article XXX (in Part X of CRR)

"Article X

Grandfathering period for Additional Tier 1 and Tier 2 Instruments

1. By way of derogation from Articles 51 and 52 of this Regulation, instruments issued prior to [date of entry into force of CRR 2] shall qualify as Additional Tier 1 instruments until [31 December 2021], where they meet the conditions laid down in Articles 51 and 52, except for the conditions referred to in points (q) and (r) of Article 52.

"2. By way of derogation from Articles 62 and 63, instruments issued prior to [date of entry into force of CRR 2] shall qualify as Tier 2 instruments at the latest until [31 December 2021] where they meet the conditions laid down in Articles 62 and 63, except for the conditions referred to in points (o) and (p) of Article 63".