10 December 2014

European Banking Authority
Tower 42
25 Old Broad Street
London EC2N 1HQ

Submitted via the EBA website

Consultation paper on draft guidelines concerning the interrelationship between the BRRD sequence of write down and conversion and CRR/CRDIV

Dear Sir / Madam

Please find enclosed AFME’s response to the EBA consultation paper on draft guidelines concerning the interrelationship between the BRRD sequence of write down and conversion and CRR/CRDIV (EBA/CP/2014/29).

Please do not hesitate to contact us if you have any questions.

Yours faithfully

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AFME
Consultation response

EBA consultation paper on draft guidelines concerning the interrelationship between the BRRD sequence of write down and conversion and CRR/CRDIV (EBA/CP/2014/29)

10 December 2014

The Association for Financial Markets in Europe (“AFME”) welcomes the opportunity to comment on the European Banking Authority (“EBA”) Consultation Paper (the “CP”) on draft guidelines concerning the interrelationship between the BRRD sequence of write down and conversion and CRR/CRDIV (EBA/CP/2014/29).

AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.1

We set out below our comments in response to the CP. References to articles are to articles of the BRRD.

A. General comments

We welcome the clarification in the draft guidelines that when applying the bail-in tool or the write down and conversion power under article 60, the resolution authority should treat capital instruments which rank equally in insolvency equally, whatever their other characteristics (the proposed “Guiding rule 1”).

We also welcome the clarification in the draft guidelines that when determining the order and amount of write down or conversion the resolution authority should apply the same treatment to all instruments, whether or not they are fully or partially included in the calculation of an institution’s own funds (the proposed “Guiding rule 2”).

The clarification provided in the draft guidelines is welcome as we consider that there is some ambiguity in the text of articles 48 and 60 and we support the proposed guiding rules. However we believe that the guiding rules should be extended to address certain additional ambiguities in the application of these provisions. We set these out below.

Impact of the portfolio cap on grandfathered AT1 instruments

First, it would be helpful for the guidelines to clarify that in the circumstances where there is a spillover from grandfathered AT1 instruments to T2 due to the portfolio cap under the CRR, those instruments are considered fully as AT1 and not T2 for the purposes of bail-in or write-down under article 60.

1 AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia. AFME is listed on the EU Register of Interest Representatives, registration number 65110063986-76.
Application of article 48(3)

An additional area of ambiguity is the application of article 48(3). We believe that the intention of this provision is to say that if an institution reaches the point of non-viability (“PONV”) and at that point there are contractual CoCos that have not triggered by their terms, then that fact of not breaching the contractual trigger will not prevent an authority from writing down or converting those CoCos at the same time as all the other instruments ranking at the same level in the insolvency hierarchy. An alternative interpretation which has been suggested, is that article 48(3) might imply that an AT1 CoCo which had not hit its contractual trigger prior to PONV would be written down/converted in sequence after liabilities falling within article 48(1)(d) but before those falling within article 48(1)(e). Confirming the intended interpretation through strengthening or extending the guiding principles to all relevant provisions within articles 48 and 60 would be beneficial.

Treatment of subordinated instruments ranked pari passu with capital instruments

A further area of uncertainty is the treatment of any instruments that do not come within the definition of “capital instruments” (for example because they are not CRR compliant nor grandfathered under the CRR/CRDIV, or grandfathered instruments when the grandfathering period expires) but rank pari passu with capital instruments in the insolvency hierarchy.

For example, for the purposes of illustration, we understand that a newly issued subordinated debt instrument with an incentive to redeem should be eligible as TLAC but would not be eligible as CRR T2, i.e. it would not be a “capital instrument”. In the case of a bail-in, however, we understand that the insolvency hierarchy should be followed so that the instrument should be bailed in equally with other instruments at the same insolvency ranking, including T2 capital instruments.

Similarly, guiding rule 1 is silent on the treatment of grandfathered “own funds” instruments at the end of the grandfathering period in 2021. Such instruments would still rank pari passu with capital instruments of the same hierarchy in insolvency, and so we believe should be treated equally with equivalent ranked capital instruments at the PONV or within a bail-in.

Hierarchy applied at the issuing entity

In addition, the use of CRR concepts to set out the sequencing in article 48 creates ambiguity in situations where CRR instruments may provide capital benefit at a consolidated group level, but are issued by different entities in a group structure, creating a clear distinction between capital ranking at a group consolidated level from the insolvency ranking applied at the legal entity. Guiding principle 1 could clarify what we believe is the intended interpretation – that the sequencing in article 48 must be applied at the level of the issuing entity – by making a clear reference to the insolvency ranking “of the issuing entity”.

Suggested amendments

The concepts above all reflect the resolution principles established in article 34, but the use of CRR definitions in article 48 gives rise to some technical ambiguity. We would welcome confirmation of the concepts outlined above through an extension of guiding rule 1. We therefore suggest that the principle established in the proposed “guiding rule 1” should also extend to any other subordinated instruments that do not come within the definition of capital
instruments and the overarching consideration should be alignment with the insolvency hierarchy at the level of the issuing legal entity. This could be reflected in the following changes to the proposed “guiding rule 1”:

“Guiding rule 1: When applying the bail in tool or the write down and conversion power at PONV, except where exclusions according to Article 44 Directive 2014/59/EU are made, the resolution authority should treat capital instruments and any other subordinated instruments which rank equally in the insolvency of the issuing entity equally, whatever their other characteristics. In particular they should be written down to the same extent or subject to the same terms of conversion.”

We consider that extending this clarification is important both for issuers and investors to be able to articulate and understand the expected ranking of all liabilities in a bail-in regardless of the “capital” characteristics of those instruments. Subject to the provisions of article 44 (covering excluded liabilities and resolution authorities’ discretion to exclude certain liabilities), we believe that the relevant insolvency rankings should apply equally in a bail-in, according to the insolvency hierarchy of the legal entity in question.

Finally, we presume that the EBA’s guiding principle 1 is meant to refer to article 44 (Scope of bail-in tool), rather than article 43 because article 44 is where the scope of the bail-in tool and exclusions is set out.

**B. Response to the question raised in the CP**

**Q1. Should the guidelines also provide further clarification on the treatment of instruments which contain different contractual triggers for conversion to shares or other instruments of ownership, or does the BRRD (in particular Article 47(2)) provide sufficient clarity?**

We consider that article 47(2) is sufficiently clear on this point.