AFME Position Paper

CRR2: Issues for EU headquartered institutions with a global footprint

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The CRR limits the inclusion of capital issued by third country subsidiaries within group consolidated capital despite those subsidiaries being fully included within the scope of group supervision and their risk weighted assets (RWAs) fully reflected in group RWAs. As a result, the subsidiary's contribution to capital resources at group level is not adequately taken into account, penalising European groups with extra-European activities. . The CRR also contains a number of unjustified restrictions on the recognition of minority interests in 3rd country non-banking entities which should be removed. This is becoming increasingly important in the context of resolution planning for groups with more than one resolution group which issue external TLAC from subsidiaries that are deemed to be resolution entities. In practice, such resolution entities are likely to be intermediate holding companies. Minority interests in such entities should be eligible for recognition when they are situated in 3rd countries.

This paper describes these issues in more detail and sets out AFME's recommendations for how these issues should be addressed in the CRR2.

1. Recognition of capital issued by subsidiaries located in third countries

Additional Tier 1 (AT1) and Tier 2 (T2) instruments issued by subsidiaries in third countries must comply with requirements specified under the current CRR (and its associated implementing regulations) to be eligible at the level of the group. However, third county requirements can differ slightly from the ones included within the CRR, even though their objectives are, to all intents and purposes, the same. Moreover, the requirements of third countries will not include references to the EU's CRR framework. This creates issues in the recognition of these instruments in group level capital

i) Conversion triggers / write down clauses

The CRR requires that AT1 instruments must include a conversion trigger (CET1<5,125%) for such instruments to be eligible as capital. When such instruments are issued from subsidiaries in third countries, to be recognised at the consolidated level, the AT1 trigger, and write-down clauses, need to be calculated in accordance with the provisions of the CRR. However, in practice, conversion or write down triggers for AT1 issued in third countries are often based on CET1 ratios calculated in accordance with *local requirements* and not the CRR.

We recommend that when these local prudential requirements are in place and they are deemed to be *equivalent* through the equivalence process these instruments must be eligible for group consolidated capital. This is to ensure that entities' contribution to both group RWAs and consolidated own funds are reflected in a symmetric and equal manner, and to recognise that resources issued locally will be available to absorb losses incurred by the subsidiaries

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ii) Point of non-viability (PONV)

Articles 52 and 63 of the proposed CRR2 require that both AT1 and T2 instruments be written down or converted to Common Equity Tier 1 instruments at the point of non- viability. This implies that instruments issued by third-country subsidiaries of EU institutions can only be considered as Additional Tier 1 or as Tier 2 instruments by their EU parent entities if PONV clauses are included in the instruments' contractual terms. Our main concern refers to the drafting of these new provisions as they refer directly to the EU law. In our experience, no third country authority accepts the introduction of references to the EU legal framework in issuance conditions. However almost all jurisdictions do have statutory frameworks or regulations that allow the absorption of losses of AT1 and T2 instruments when the entity is not viable. Therefore, in the case of issuance by a subsidiary in a jurisdiction where the local competent authority has powers with regards to resolution or other write down or conversion powers, the decisions that may be taken by the local competent authority should be considered as effective and enforceable for the purposes of Art 52 and Art 63.

2. Unnecessary restrictions in recognising minority interests in third countries must be removed

As a general rule, the CRR allows minority interest to be included in own funds up to the level of the capital requirements. However, there are unjustified restrictions on the minority interests that can be included within group consolidated capital depending on the types of entities from which minority interests arise[1].

Minority interests in 3rd country holding companies

Currently, minority interests arising in holding companies in third countries are excluded even where such entities might be subject to prudential regulation in their respective jurisdictions. We note that as part of the EBA's feedback on its final draft RTS for Own Funds Part III, the EBA explicitly recognised this unequal treatment with respect to minority interests arising from holding companies and alluded to the need for flexibility within the CRR. Specifically, the EBA noted that it 'has some sympathy for arguments suggesting that minority interests arising from third country holdings should qualify for inclusion in consolidated CET1' but reads Article 81 (of the CRR) as preventing it.

We therefore welcome the CRR2 proposal to amend the current provisions with a view to allow minority interests in holding companies in third countries to be included if "*an intermediate financial holding company in a third country that is subject to the same rules as credit institutions of that third country and where the Commission has decided in accordance with Article 107(4) that those rules are at least equivalent to those of this Regulation*" (Art 81 amended). A further amendment is however required to extend the scope to mixed financial holding companies which are included within the scope of banking consolidated requirements but have not been referenced alongside financial holding companies in the amended Articles 81 and 82

Moreover, in practice, intermediary holding companies are not likely to be subject to the exactly *same* rules as credit institutions. We therefore suggest that where such entities are subject, according to the local competent authority, to prudential requirements and supervision *as stringent as those applied to credit institutions of that third country in terms of robustness* and where the Commission has decided in accordance with Article 107.4 that those requirements are at least equivalent to those of the EU regulation, any minority interest or

[1] AFME has a number of further comments on the calculation of minority interests in CRR Articles 81 -84 which can be viewed here.

qualifying own funds issued from such entities should also be eligible for inclusion in consolidated requirements.

The ability to include regulatory capital instruments issued by non-banking entities in third country jurisdictions is increasingly important in the context of resolution planning. In particular, in accordance with final FSB requirements for Total Loss Absorbing Capacity (TLAC), G-SIB groups with more than one resolution group will likely issue external TLAC from subsidiaries that are deemed to be resolution entities. In practice, such resolution entities are likely to be intermediate holding companies. Banking groups should therefore not be penalised from a CRR perspective if resolution entities choose to meet TLAC requirements through regulatory capital instruments. Instead, such capital issued by non-banking subsidiaries should be eligible for group consolidated capital purposes. Bifurcation in treatment is not appropriate given the common underlying rationale for both regimes, namely ensuring adequate loss absorbency.

Minority interests in third country investment firms

Articles 81 and 82 of the CRR restrict the inclusion of Common Equity Tier 1 and Additional Tier 1 and Tier 2 capital issued by subsidiaries to "institutions". The Article 4 of the CRR defines "institution" as a credit institution or an "investment firm", the latter defined as a "person as defined in point (1) of Article 4 (1) of Directive 2004/39/EC, which is subject to the requirements imposed by that Directive, excluding the following (…)".

Therefore, a strict reading of the current CRD/R requirements is that *only* the recognition of minority interests in investment firms subject to *EU* (MiFID) requirements is allowed, whereas as those arising from all 3rd country credit institutions are allowed. This asymmetric treatment for investment firms and credit institutions is not justified, as investment firms can be subject to regulatory requirements *as prudent* as those contained within EU directives/regulations. We therefore request that these provisions in relation to 3rd country investment firms be clarified in the CRR2 so as not to fully disqualify the capital issued by these firms from consolidated own funds.

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