

EBA/Op/2015/01

17 February 2015

Opinion of the European Banking Authority on the review of the appropriateness of the definition of 'eligible capital' pursuant to Article 517 of Regulation (EU) No 575/2013

Introduction and legal basis

1. In accordance with Article 517 of Regulation (EU) No 575/2013¹ (Capital Requirements Regulation, CRR), the Commission must by 31 December 2014 review and report to the European Parliament and the Council on the appropriateness of the definition of 'eligible capital' being applied within the context of Title III of Part Two and Part Four of the CRR.
2. On 20 December 2013, to carry out that review, the Commission sought technical advice from the European Banking Authority (EBA) to determine whether or not the definition of 'eligible capital' is appropriate for defining 'large exposures', setting 'large exposures' limits, determining the capital requirements applicable to investment firms with limited investment services and determining the prudential treatment for qualifying holdings outside the financial sector. Therefore, this opinion is addressed to the Commission.
3. In this opinion, the EBA provides general comments on 'eligible capital', that are relevant both for the large exposures framework as well as for investment firms and qualifying holdings. In addition, the EBA provides specific comments applicable only to the 'eligible capital' definition in the large exposures framework.
4. The EBA competence to deliver this opinion is based on Articles 8(1)(a), (2)(g) and 34(1) of Regulation (EU) No 1093/2010², as amended, as the definition of 'eligible capital' for credit institutions and investment firms relates to the EBA's area of competence.
5. In accordance with Article 14(5) of the Rules of Procedure of the Board of Supervisors³, the Board of Supervisors has adopted this opinion.

General comments

6. The EBA provides some preliminary views regarding the definition of 'eligible capital', on the basis of experience or information gathered during the first year of application of the CRR.
7. The call for advice recalls that the notion of 'eligible capital' was introduced so that credit institutions and investment firms would not be encouraged to reduce the regulatory constraints by issuing only Tier 2 capital.
8. From 1 January 2014, the 'eligible capital' definition specified in Article 4(1)(71) of the CRR replaced the 'own funds' definition for defining 'large exposures' and setting 'large exposures' limits. The definition shall also be used to determine the capital requirements applicable to

¹ Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1).

² Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority) amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).

³ Decision adopting the Rules of Procedure of the European Banking Authority Board of Supervisors of 24 November 2014 (Decision EBA DC 2011 001 (Rev4)).

investment firms with limited investment services and to determine the prudential treatment for qualifying holdings outside the financial sector⁴. The difference between the two definitions is that the amount of Tier 2 capital recognised as 'eligible capital' may not exceed one third of Tier 1 capital whereas there was no limit for the inclusion of Tier 2 capital in the 'own funds' definition.

9. The definition of 'eligible capital' was introduced without conducting an impact assessment, so a three-year transitional regime was introduced in Article 494 and a review clause in Article 517 of the CRR. To facilitate the transition to the new definition, the transitional clause allows eligible capital to include Tier 2 capital up to 100% of Tier 1 capital during 2014, 75% during 2015 and 50% during 2016.
10. Since there is a transitional regime in place until the end of 2016, there is not yet any experience regarding the use of the definition of 'eligible capital'. At present, the EBA is not aware of any concerns raised by institutions regarding the use of this definition. Furthermore, the EBA is not aware of any empirical evidence that would lead to the conclusion that the new stricter capital base for the large exposures regime would have a significant detrimental impact on institutions' exposures. However, this is not based on any collection of data – and this data would, in any case, need to be based on simulations and collected on an *ad hoc* basis.
11. The EBA could consider collecting data, if still required, towards the end of the transitional period.

Specific comments regarding the application of the definition of 'eligible capital' to the large exposures framework

12. The definition of 'eligible capital' is used, among other things, in the context of the large exposures regime, specifically for defining 'large exposures' (Article 392 of the CRR) and setting 'large exposures' limits (Article 395 of the CRR).
13. The EBA notes that, in April 2014, the Basel Committee on Banking Supervision (BCBS) published standards on the supervisory framework for measuring and controlling large exposures⁵. These standards specify the eligible capital base for defining 'large exposures' and its limits as the effective amount of Tier 1 capital fulfilling the criteria defined in Part 1 of the Basel III framework.⁶

⁴ With an additional adjustment for qualifying holdings, due to the fact that qualifying holdings may be deducted under Article 36(k)(i) or risk weighted for the 'own funds' definition. However, within the context of Article 89, there should be no deduction of qualifying holdings.

⁵ These standards are applicable to all internationally active banks and are expected to be fully implemented by the relevant jurisdictions by 1 January 2019. There is an option to extend the application of the standards to a wider range of banks, with the possibility, if deemed necessary, to develop a different approach for banks that usually fall outside the scope of the Basel framework.

⁶ 'Basel III: A global regulatory framework for more resilient banks and banking systems' dated December 2010 (rev. June 2011).

14. The EBA considers it desirable to conduct an appropriately timely comprehensive review of the EU large exposures regime to align it, as far as possible, with the BCBS standards on the supervisory framework for measuring and controlling large exposures. In this vein, it is suggested to the Commission that any review of the eligible capital base should be postponed until a large exposures review is carried out. It is also suggested that there is a need to conduct a quantitative impact study (QIS) in the context of this review and that this QIS should assess the feasibility of different options for defining the eligible capital basis in relation to large exposures.

This opinion will be published on the EBA's website.

Done at London, 17 February 2015

[signed]

Andrea Enria

Chairperson

For the Board of Supervisors