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<b>Status</b>	Final Q&A
<b>Legal act</b>	Regulation (EU) No 575/2013 (CRR)
<b>Topic</b>	Own funds
<b>Article</b>	28, 52, 63
<b>Paragraph</b>	1, 1, 2
<b>Subparagraph</b>	1
<b>COM Delegated or Implementing Acts/RTS/ITS/GLs/Recommendations</b>	Not applicable
<b>Article/Paragraph</b>	not applicable - CRR.28.1.L
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<b>Disclose name of institution / entity</b>	Yes
<b>Name of institution / submitter</b>	De Nederlandsche Bank
<b>Country of incorporation / residence</b>	Netherlands
<b>Type of submitter</b>	Competent authority
<b>Subject matter</b>	Capital eligibility in relation to intragroup guarantees - interpretation of "seniority"
<b>Question</b>	How should we interpret "seniority" as used in Article 28(1)(l) of Regulation (EU) No 575/2013 (CRR) (and likewise in Articles 56(e) and 63(e))?
<b>Background on the question</b>	For the purpose of verifying whether capital instruments meet the eligibility criteria we need to establish whether any guarantee the instruments are covered by would "enhance the seniority of the claim". However we find that there may be two distinct possible interpretations. At one hand "seniority" could be interpreted with a "legal connotation" in mind. This in practice means that the seniority of the claim is the priority of claimholders to the distribution from the residual assets in the event of insolvency or liquidation. On the other hand "seniority" could be interpreted with an "economic ranking concept" in mind. This comes down to the notion that seniority could mean a privileged order and timing of payments in any event (including

insolvency or liquidation) versus the situation where no guarantee would exist. Crucially the “legal connotation” would evaluate “seniority” as something relative to other claims, while an “economic ranking concept” would evaluate “seniority” both against other claims without guarantees as well as against the same claim would it be unguaranteed. Furthermore the interpretation of the CRR text following an “economic ranking concept” could place substantial stress on the absence of the adjective “in insolvency or liquidation” in CRR.28.1.l as an intended differentiation from CRR.28.1.m. This difference could indicate that:

- CRR.28.1.l covers guarantees - effective under any circumstance - provided by those listed related parties, while
- CRR.28.1. covers guarantees - only insofar as those effective in the event of insolvency or liquidation - provided by anyone.

Notes: We note that while lawyers may be inclined to interpret "seniority" with a legal settlement context in mind, this reading is not at all supported by the CRR text. However, also the "economic ranking concept" is nowhere literally supported in the CRR. As a second side note we observe that an interpretation of "seniority" with a “legal connotation" in mind would render CRR.28.1.l redundant as the very same eligibility condition is also included in CRR.28.1.m. As a third side note we observe that an interpretation of "seniority" with an "economic ranking concept" would make sense from a prudential perspective, while an interpretation with a “legal connotation” in mind would not address concerns arising in some specific circumstances.

Example: To see the critical difference between these two possible interpretations, imagine the following situation:

- A large credit institution has guaranteed its smaller subsidiary which is also a credit institution.
- Both entities have issued CET1 and T2 instruments
- All CET1 instruments of the subsidiary are held by the parent institution
- All other instruments in question are held by outside investors. At the consolidated level, the capital comprises of all instruments issued by the parent institution and (subject to provisions on minority interests) to some extent the T2 instruments issued by the subsidiary institution. Critically if the subsidiary would enter insolvency or liquidation, while the parent would be able to meet all the claims subject to the guarantee, and hence would not default itself, the T2 instruments would not have any loss bearing capacity, as those the claims arising from instruments are covered by the guarantee. It is important to note that T2 instruments are allowed to become callable / repayable upon the insolvency or liquidation of the issuing institution (CRR.63.k). Hence while those T2 instrument were recognized as eligible instruments at the consolidated level, the existence of a guarantee covering those instruments would violate the gone-concern capital principle underlying the notion of T2 instruments, as the parent would be obligated to repay the instruments.

Those supporting the interpretation of “seniority” under an "economic ranking concept" explain that CRR provisions CRR.28.1.l, CRR.56.e and CRR.63.e are intended to prevent the above example situation. Under an economic notion of “seniority” the guarantee covering the T2 instruments would be interpreted as creating a privilege (=enhanced seniority) versus

	<p>the non-guaranteed situation. The holder of the T2 instrument issued by the subsidiary would also be privileged versus any holder of the T2 instruments issued by the parent, as those holders of T2 instruments issued by the parent would be entitled to only the remainder of the combined assets of the two entities, should the parent default after the insolvency of its subsidiary. Those supporting an interpretation of the CRR with a pure legal connotation in mind would probably argue that as long as the guarantee would not change the position of the T2 instruments in the event of the joint default of parent and subsidiary, the existence of the guarantee would not be in violation of CRR.28.1.1. It should be noted that in the event of default of only the subsidiary (which is possible even if the parent unconditionally guarantees the subsidiary), such an interpretation would imply that T2 instruments would not always have a gone concern loss-absorption characteristic.</p>
<b>Final answer</b>	<p>The statement that "the instruments are neither secured nor subject to a guarantee that enhances the seniority of the claim", as used in Article 28(1)(l), Article 52(1)(e) and Article 63(e) of Regulation (EU) No. 575/2013, shall prohibit any enhancement, be it legal or economic, by the specified entities of any claim under an instrument to payment vis-à-vis the claims of more senior positions in the institution's creditor hierarchy. The claim under the instrument, including the payment of principal or interest, may exist on the going or gone concern status of the institution. More senior positions within regulatory capital should be interpreted as capital instruments of a more senior tier of capital.</p>
<b>Link</b>	<p><a href="https://www.eba.europa.eu/single-rule-book-qa/-/qna/view/publicId/2014_903">https://www.eba.europa.eu/single-rule-book-qa/-/qna/view/publicId/2014_903</a></p>

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