22nd February 2017

EBA Q&A

Ref.: General framework on the application for permission to carry out discretionary trading activity over treasury shares

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Subject Matter: Prior permission for repurchase of CET 1 instruments for discretionary trading activity over treasury shares for a certain predetermined amount.

The purpose of this memo is to analyse the general framework applicable to the permission to repurchase Common Equity Tier 1 ("CET 1") instruments as set forth in Regulation (EU) 575/2013[1] ("CRR") and Commission Delegated Regulation (EU) 241/2014[2] ("Delegated Regulation"), in connection with the discretionary trading activity over treasury shares.

In particular, this memo analyses: (i) the different situations set out in the Delegated Regulation and whether they could be applicable to the discretionary trading activity over treasury shares; and (ii) the relationship between the permission granted and the deductions regime on own funds.

1. Situations for repurchase foreseen in the Delegated Regulation

Without prejudice to the particular repurchases, redemptions or reductions that may be effected (repurchase programmes, capital reductions, early redemptions of issuances of capital instruments) and that are generally provided for in article 77 of CRR, article 29 of the Delegated Regulation describes three different situations for repurchasing capital instruments.

For the purposes of the analysis of the different situations, this memo will only refer to the repurchases of CET 1 instruments (shares).

1.1. Repurchases "for market making purposes" (article 29.3)

Competent authorities may give their prior permission to repurchase CET 1 instruments for a certain predetermined amount (subject to some thresholds) provided that all repurchases are carried out "*for market making purposes*".

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[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.

[2] Commission Delegated Regulation (EU) No 241/2014, of 7 January 2014, supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for Own Funds requirements for institutions.

In connection with "*market making*", neither CRR nor the Delegated Regulation provide a definition for this concept. However, article 2.1.k) of Regulation (EU) No 236/2012[3] defines "*market making activities*" as "*the activities of a credit institution […] where it deals as principal in a financial instrument, whether traded on or outside a trading venue, in any of the following capacities:*

(i) by posting firm, simultaneous two-way quotes of comparable size and at competitive prices, with the result of providing liquidity on a regular and ongoing basis to the market;

(ii) as part of its usual business, by fulfilling orders initiated by clients or in response to clients' requests to trade;

(iii) by hedging positions arising from the fulfillment of tasks under points (i) and (ii)."

Furthermore, the Proposal for a Regulation of the European Parliament and of the Council on structural measures improving the resilience of EU credit institutions, prepared by the European Commission, defines, in article 4.12, "*market making*" as "*a financial institution's commitment to provide market liquidity on a regular and on-going basis, by posting two-way quotes with regard to a certain financial instrument, or as part of its usual business, by fulfilling orders initiated by clients or in response to clients' requests to trade, but in both cases without being exposed to material market risk*".

Once the concept of "*market making*" is established, its adequacy to the concept of "discretionary trading activity over treasury shares" should be assessed. In this regard, it should be taken into consideration that the discretionary trading activity over treasury shares is a wide common activity carried out by listed companies to engage purchases and sales of their own shares on entirely discretionary basis (with no commitment from the listed company to carry out purchases or sales and no expectation from the market that such activity will occur at any given price or for a given volume).

In light of the above, it is our understanding that the discretionary trading activity over treasury shares carried out by credit entities cannot be considered as a "*market making*" activity, as it does not meet in any event the essential requirements of the market making activity, namely:

(i) The existence of a "*commitment*". On the contrary, the execution of the discretionary trading activity over treasury shares is absolutely at the discretion of the entity with no commitment to carry out any transaction at any given price and for any given volume.

[3] Regulation (EU) No 236/2012 of the European Parliament and of the Council, of 14 March 2012, on short selling and certain aspects of credit default swaps.

(ii) To "*provide market liquidity on a regular and on-going basis*". In this regard, it should be noted that (i) the provision of liquidity is not a characteristic of the discretionary trading activity over treasury shares requirement (e.g. large listed companies' shares are sufficiently liquid but are usually subject to discretionary trading activity over treasury shares); and (ii) the regular and on-going basis requirement cannot be fulfilled as there is no commitment from the listed company neither expectation from the market that purchases or sales over treasury shares will occur at any given price or for a given volume. Additionally, it should be taken into account that companies are self-subject in a number of cases to "black-out periods" (e.g. periods leading to results announcements whereby listed companies could be self-prevented from executing orders over their own shares).

In addition, the Spanish Securities Exchange Commission ("CNMV") has expressly stated that liquidity agreements (i.e. activity similar to market making activity) are expressly excluded from the definition of discretionary trading activity over treasury shares[4].

Consequently, such application for permission regarding discretionary trading activity over treasury shares shall not be subject to the conditions set out in article 29.3 of the Delegated Regulation.

1.2. Repurchases for employees' remuneration purposes (article 29.4)

Competent authorities may also give in advance their permission to repurchase CET 1 instruments "*where the related own funds instruments are passed on to employees of the institution as part of their remuneration*". This situation does not relate to the discretionary trading activity over treasury shares.

1.3. Recurring repurchases with other purposes (article 29.5)

Lastly, a competent authority may give its permission in advance to carry out a set of repurchases of CET 1 instruments for a predetermined amount with no specific purpose, as long as "*the amount of own funds instruments to be called, redeemed or repurchased is immaterial in relation to the outstanding amount of the corresponding issuance after the call, redemption or repurchase has taken place*".

In our view, this situation is the only one that could fit with the case of the discretionary trading activity over treasury shares, since the permission is granted for a group of transactions (of an undetermined number) but for a specific maximum amount, whereas the general permission established in article 77 of CRR refers to specific and particular transactions, and the

[4] Please see the Criteria published in this matter by the CNMV ("*Criterios que la Comisión Nacional del Mercado de Valores recomienda que sean observados por los emisores de valores y los intermediarios financieros que actúen por cuenta de los emisores de valores en su operativa discrecional de autocartera*"), dated 18 July 2013.

purposes foreseen in article 29.3 and 29.4 do not apply to the discretionary trading activity over treasury shares.

2. Deductions from own funds

Articles 36.1.f) and 42 of CRR provide for the obligation of credit entities to deduce from its own funds any own shares that the entity may hold, directly or indirectly, in treasury.

In turn, article 28.2 of Delegated Regulation lays down that an institution is required to deduce from the amount of CET 1 instruments the corresponding amount of own shares to be repurchased "*where redemptions, reductions and repurchases are expected to take place with sufficient certainty, and once the prior permission of the competent authority has been obtained* […]. *Sufficient certainty is deemed to exist in particular when the institution has publicly announced its intention to redeem, reduce or repurchase an own funds instrument*".

The obligation contained in article 28.2 of Delegated Regulation evidences that deductions from own founds prior to the execution of the repurchases (as an exception to the general regime established in articles 36.1.f) and 42 of CRR) would only be applicable to those situations where sufficient certainty exists regarding the execution of such repurchases, including in any case those situations where public announcements are made in relation to the repurchase.

In this regard, it should be born in mind that the EBA, through the *Single Rulebook Q&A*[5], has clarified its opinion on the obligation to deduct own funds whose repurchase has been permitted for "*market making*" purposes (article 29.3 of the Delegated Regulation) at the time when permission is given for the total amount authorised, since (i) the essence of the "*market making*" involves a prior and firm commitment to post purchase orders up to a determined amount; and (ii) such commitment shall be publicly communicated to the market prior to execution (under securities market regulations); and therefore it is reasonable to require prior deduction as sufficient certainty about the effective repurchase exists and a public announcement on the effective repurchase is made.

Notwithstanding the foregoing, pursuant to article 28.2 of Delegated Regulation, prior deduction shall not be required where the repurchase of own funds does not meet with the conditions of certainty and publicity, for example in the case of the discretionary trading activity over treasury shares as no unconditional commitment is assumed for posting firm orders for purchasing ordinary shares, (as opposed to, for example, market making activity). On the contrary, credit entities have full discretion to post orders when executing their discretionary trading activity over treasury shares and there are times during which they may not post orders (such as in the period leading to a results announcement).

Additionally, no announcements are or will be made in relation to the intention of any credit entity to execute its discretionary trading activity over treasury

[5] Question ID 2014_1352, published on 31 October 2014; and Question ID 2015_2042, published on 25 September 2015.

shares, as the only public information related to the discretionary trading activity over treasury shares is the on-going reporting to the applicable authorities (e.g. Bank of Spain and CNMV) on already executed transactions.

Therefore, we understand that a permission to carry out the discretionary trading activity over treasury shares under article 29.5 of Delegated Regulation should not involve a subsequent deduction from own funds at the time when permission is granted, since (i) no public announcements or communications are made in relation to the trading activity; and (ii) no commitment is assumed to purchase up to a predetermined amount; as opposed to “market making” activity. All of which without prejudice to the corresponding deductions to be made whenever each repurchase order on own shares is carried out from time to time, under the general regime established in articles 36.1.f) and 42 of CRR.