EBA Opinion on legacy instruments: outcome of its implementation

Background

1. In October 2020, the EBA published its Opinion on the prudential treatment of so-called ‘legacy instruments’, in the context of the end of the grandfathering period in December 2021. When reviewing EU institutions’ legacy instruments and examining the clauses that led to their grandfathering, the EBA identified two main issues which could create so-called infection risk, i.e. the risk of other layers of own funds or eligible liabilities instruments being disqualified. The first issue relates to the flexibility of distribution payments principle, while the second involves clauses that might contradict the eligibility criterion of subordination among the different layers of own funds and eligible liabilities. Several options were put forward for institutions to manage these legacy instruments.

2. The EBA complemented its Opinion with additional guidance and interpretation via the publication of its AT1 report. The report clarified that, as per the Opinion, there are several tests that the instruments need to pass in addition to the test of the infection risk. In particular, legacy instruments that moved into lower tier of regulatory capital as fully eligible instruments need to comply with Regulation (EU) No 575/2013 (CRR) and relevant Regulatory Technical Standards, as supplemented by related guidance on the consistent and effective application of the regulatory framework provided by EBA Q&As and monitoring reports. The EBA also expressed reserves on a multiple layered structure for Tier 2 instruments.

3. In 2021, and as alluded already at the time of the publication of its guidance, the EBA, in close cooperation with competent authorities, monitored the actions taken by institutions regarding legacy instruments, placing particular focus on the use of the proposed options across and within jurisdictions with a view to ensuring consistent application.
4. Shortly after the publication of the Opinion, competent authorities intensified the discussions with institutions to identify the outstanding legacy instruments and to understand better institutions’ intentions regarding legacy instruments that might pose infection risk and the planned actions to address that risk. Several discussions with competent authorities on the supervisory actions undertaken were organised by the EBA in the course of 2021. In addition, the EBA considered the transposition of specific provisions of Directive 2014/59/EU (BRBD)\(^4\), in particular of its Article 48(7), into national legislation, looking at how this might alleviate concerns about the existence of infection risk linked to subordination aspects.

5. The EBA previously communicated that it would ensure transparency on the implementation of its Opinion; this is the purpose of this communication.

Overview of the monitoring of the implementation of the EBA Opinion

6. As a result, the EBA conveys the following messages:

- The EBA Opinion put forward three possible options for addressing the infection risk: i) call, redeem, repurchase or buyback the instrument; ii) amend the T&Cs, iii) keep the instrument as non-regulatory capital (the so-called last resort option) under a strong demonstration that the first two options cannot be pursued;

- Competent authorities worked with the institutions under their direct supervisory remit for identifying the possible challenges that legacy instruments might pose to fully eligible ones and discuss the way forward envisaged for these legacy instruments, on the basis of the options offered in the EBA Opinion. The discussions have been finalized in the very vast majority of the EU jurisdictions;

- As indicated in the AT1 report at the time of its publication, 19 EU competent authorities reported that, for institutions under their direct supervision, there are no outstanding legacy instruments or outstanding legacy instruments posing infection risk and, as such, these were assessed as outside the scope of the EBA Opinion. The EBA has further exchanged with its concerned members on the actions planned/reported by institutions. In this context, the EBA enquired whether:

  i. competent authorities were satisfied with the demonstration provided by the institutions in cases where the instruments would not be addressed under the first two options of the EBA Opinion and the last resort option is followed;

  ii. competent authorities were satisfied with the consistency of treatment for instruments with similar characteristics in a given jurisdiction, and

iii. Competent authorities were satisfied that legacy instruments that some institutions might have chosen to keep as regulatory instruments in a lower category of capital meet Regulation (EU) No 575/2013 (CRR)\(^5\) and relevant Regulatory Technical Standards, as supplemented by related guidance on the consistent and effective application of the regulatory framework provided by EBA Q&As and monitoring reports.

- Overall, the monitoring of the implementation of the EBA Opinion shows that significant actions have been put in place to address the infection risk. In general, institutions demonstrated willingness to clean up their balance sheets and ensure a further strengthened loss absorbency capacity mostly via the termination of legacy instruments. In some cases, this came with an impact on their CET1.

- Based on the input collected, a significant number of instruments has been already resolved in the course of 2021 through either i) the option to call, redeem or buy-back the legacy instrument (option used in the very vast majority of the cases) or ii) the option to amend their terms and conditions, while for a few instruments the infection risk was deemed to be solved via the national transposition of Article 48(7) of the BRRD;

- For a limited residual number of instruments, actions are still ongoing/under consideration, with call options planned to be exercised in the course of 2022 or later on, while a few will be kept in a lower category of own funds or as eligible liabilities or in the balance sheet as non-regulatory capital. The EBA expects that a few more actions could be undertaken or announced in the near future.

- Competent authorities will keep monitoring the situation for the residual cases where the actions are still in progress or where instruments would be kept in a lower category of own funds or as eligible liabilities, and report to the EBA.

- Finally, it is important to recall that the primary objective of the EBA’s Opinion was to address possible challenges in the quality of institutions’ own funds and eligible liabilities posed by the end of the CRR1 grandfathering period. As a result, capital instruments that were grandfathered during the transition period ending December 2021 were under the scope of the EBA’s monitoring exercise to date. That said, it is acknowledged that a new generation of legacy instruments has been created by the new grandfathering period running until June 2025 and resulting from the provisions Regulation (EU) 2019/876 (CRR2)\(^6\) amending CRR. In this context, the EBA expects that institutions and competent authorities would apply consistently the guidance and principles of the EBA’s Opinion for identifying potential issues and develop the

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appropriate actions for addressing them. The EBA will re-assess in due time the need for additional scrutiny on these actions and on the remaining stock of legacy instruments.

Conclusion

7. As a conclusion, the EBA considers that globally necessary actions have been taken by institutions and competent authorities to exit the Regulation (EU) No 575/2013 before CRR2 amendments (CRR1) grandfathering period in an appropriate manner. Competent authorities will continue to monitor over time the residual limited and specific cases, and the implementation of the actions planned in 2022 and beyond, also in the context of the CRR2 legacy instruments, where applicable.