THE CHAIRPERSON

Floor 24-27, Tour Europlaza
20 Avenue André Prothin
92400 Courbevoie, France

T: +33 186 526 831
E: JoseManuel.Campa@eba.europa.eu

https://eba.europa.eu

Richard East
Senior Partner
Quinn Emanuel Urquhart & Sullivan, LLP
90 High Holborn
London WC1V 6LJ
United Kingdom

EBA-2024-D-4943

17 December 2024

Subject: BFCM – Legacy AT1 instruments

Dear Mr East,

In a letter sent to the EBA on 18 June 2024, you expressed several concerns on behalf of noteholders relating to the intention of Banque Fédérative du Crédit Mutuel (BFCM) to keep three instruments disqualified from own funds and eligible liabilities (MREL) in its balance sheet. Concerns were raised in particular, in relation to the status of the notes in the creditor hierarchy and the potential distortions to the application of bail-in in resolution.

One of the tasks of the EBA is to ensure consistent, efficient, and effective application of the acts referred to in Article 1(2) of the EBA founding Regulation, which includes the application of the criteria on the quality of own funds and eligible liabilities instruments laid down in the capital requirements Regulation (EU) No 575/2013 ('CRR'). More specifically, the EBA is also entrusted by Article 80(1) CRR with the task of monitoring the quality of such instruments across the Union. Concurrently, the EBA further plays a key role in monitoring and assessing resolution practices across the EU and is entrusted by Directive (EU) No 2014/59/EU ('BRRD') with the consistent application of resolution practices to safeguard financial stability.

First, the EBA takes this opportunity to recall that it has always been an EBA expectation, based on its Opinion on legacy instruments[1], that legacy instruments should be eliminated through time, to respect the principle of the grandfathering provisions, to ensure a clear subordination ranking and prevent unnecessary complexity. The ultimate objective of the Opinion was to communicate the expectation that the grandfathering provisions were meant to allow sufficient time for banks to exit legacy instruments in order to clean their capital structure, in particular, in cases where they could easily do

[1] EBA-Op-2020-17 Opinion on legacy instruments.pdf (europa.eu)

so (via call options as the easiest way forward). In this regard, keeping legacy instruments in the balance sheet was considered to be a last resort option, where the institution would demonstrate that neither of the other options provided in the Opinion is available, and considering the solution via the transposition of Article 48(7) BRRD. In addition, the Opinion identified possible issues that may arise if the instruments are kept in the balance sheet outside any regulatory layer while still ranking pari passu with existing eligible instruments. When publishing the outcome of the implementation of its Opinion on 7 July 2022, the EBA stressed in particular that, while significant efforts to address the issues related to legacy instruments had been made, authorities would continue to monitor the residual limited and specific cases, and the implementation of the actions planned.

Second, the EBA has carefully assessed the concerns raised by your letter, in particular, the aspects related to ranking and subordination under EU laws. The EBA concluded that BFCM correctly grandfathered the concerned instruments under CRR1 provisions and disqualified them at the end of the grandfathering period from all layers of capital and MREL. However, the EBA considers that the fact that the instruments are disqualified but based on the French transposition of Article 48(7) BRRD still rank pari passu with fully eligible own funds, creates undue complexity within the balance sheet of the issuer, and raises concern in terms of ranking.

While the CRR does not explicitly cover the case of legacy instruments sitting in between regulatory layers in terms of their ranking, it is our view that as of the end of the grandfathering period, all legacy instruments were meant to have disappeared. Contrary to this, the EBA has identified issues in relation to the ranking of the instruments under the BRRD provisions.

The assessment of the instruments should be based on the prudential framework as a whole, i.e. it is thereby necessary to assess whether the institution complies with the provisions and objectives of CRR and BRRD. In particular, the EBA would like to point out the original co-legislators' intent in both legislation: the grandfathering provisions under CRR and the consistent implementation of the loss absorption framework within the EU under BRRD.

From a BRRD perspective, and considering the French transposition of Article 48(7) BRRD[2], the pari passu ranking of legacy own funds instruments with outstanding instruments deviates from the hierarchy provided for in Article 48(7) of the BRRD which requires on the sequencing of write down and conversion that "*all claims resulting from own funds items have, in national laws governing normal insolvency proceedings, a lower priority ranking than any claim that does not result from an own funds item*". Because of the non-retroactive transposition of Article 48(7) BRRD in France, the instruments at stake, though disqualified from regulatory layers of own funds and eligible liabilities, still rank *pari passu* with fully eligible own funds. On this stance, the EU's Commission Interpretative Notice[3] on the BRRD states that it should not be possible for institutions to hold any liability ranking *pari passu* with own funds that is not own funds items, and that Article 48(7) is intended to ensure that *"where own funds items are written down or converted […] there are no other liabilities ranking pari passu with or*

[2] Article L. 613-30-3 of the French Monetary and Financial Code

[3] See EU Commission Interpretative Notice on BRRD, relating to the interpretation of certain legal provisions of the revised bank resolution framework in reply to questions raised by Member States' authorities 2020/C 321/01 (link), in particular Q&A 58 and 59

below such items". In the case at stake, the write-down and conversion sequencing set forth by Articles 48(1) and 60(1) BRRD is not met either.

In addition, as mentioned above, the options contained in the EBA Opinion on legacy instruments and issued in accordance with Recital 119 of CRR whereby "*capital instruments that do not comply with the definition of own funds laid down in this Regulation should be phased out*" were meant for institutions to explore how to fully dispose of remaining legacy instruments to clean their capital structure and to ensure a clear subordination ranking. Consequently, the presence of legacy instruments sitting in the insolvency ranking among own funds layers creates undue complexity in the capital stack. In the case at hand, the instruments contain in their terms and conditions call options that can be exercised on a regular basis by the institution.

For all the above reasons it is EBA's view that the institution should target the redemption of these instruments.

This assessment has been shared with the European Central Bank (SSM), the Autorité de Contrôle Prudentiel et de Résolution (ACPR) and the Single Resolution Board (SRB) for their consideration in taking the necessary steps, in particular in relation to their respective scope of action and with regard to the above referred EBA Opinion on legacy instruments.

The EBA intends to publish this letter on its website.

Yours sincerely,

[Signed]

José Manuel Campa