



EBA REPORT

ON THE MONITORING OF TLAC-/MREL-ELIGIBLE
LIABILITIES INSTRUMENTS OF EUROPEAN UNION
INSTITUTIONS – UPDATE

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EBA

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Abbreviations

AT1	Additional Tier 1
BRRD	Bank Recovery and Resolution Directive
CET1	Common Equity Tier 1
CRD	Capital Requirements Directive
CRR	Capital Requirements Regulation
EBA	European Banking Authority
EIOPA	European Insurance and Occupational Pensions Authority
ESMA	European Securities and Markets Authority
ESG	environmental, social and governance
ESRB	European Systemic Risk Board
EU	European Union
FSB	Financial Stability Board
G-SIB	global systemically important bank
G-SII	global systemically important institution
MTN	medium-term note
MREL	minimum requirement for own funds and eligible liabilities
Q&A	question and answer
SNP	senior non-preferred
SP	senior preferred
SRMR	Single Resolution Mechanism Regulation
TLAC	total loss-absorbing capacity

Executive summary

Reasons for publication

1. On 20 May 2019, co-legislators adopted a package of amendments to the banking framework (CRR2¹, CRD5², BRRD2³ and SRMR2⁴). The banking package updates, inter alia, the framework for the minimum requirement for own funds and eligible liabilities (MREL) and implements the FSB total loss-absorbing capacity (TLAC) standard⁵ in EU legislation. CRR2 also expands the scope of the EBA ongoing review of the quality of own funds to the quality of TLAC/ MREL-⁶ 'eligible liabilities instruments'.
2. In addition to its general market monitoring and assessment tasks in the areas of its competence (Article 8(1)(f) in conjunction with Article 32(1) of the EBA Regulation⁷), Article 80(1) of the CRR states that the 'EBA shall monitor the quality of own funds and eligible liabilities instruments issued by institutions across the Union and shall notify the Commission immediately where there is significant evidence that those instruments do not meet the respective eligibility criteria set out in this Regulation'.
3. Pursuant to the same article, 'competent authorities shall, without delay and upon request by EBA, forward all information to EBA that EBA considers relevant concerning new capital instruments or new types of liabilities issued in order to enable EBA to monitor the quality of own funds and eligible liabilities instruments issued by institutions across the Union'.
4. Furthermore, according to Article 25(2) of the EBA Regulation, 'the Authority [EBA] may identify best practices aimed at facilitating the resolution of failing institutions and, in particular, cross-border groups, in ways which avoid contagion, ensuring that appropriate

¹ Regulation (EU) 2019/876 of 20 May 2019 amending Regulation (EU) No 575/2013, OJ L 150/01, 7.6.19, p. 1-225. For convenience, in this note 'CRR2' designates the consolidated CRR, following the adoption of Regulation (EU) 2019/876.

² Directive (EU) 2019/878 of 20 May 2019 amending Directive 2013/36/EU, OJ L 150/253, 7.6.19, p. 253-295. For convenience, in this note 'CRD2' designates the consolidated CRD following the adoption of Directive (EU) 2019/878.

³ Directive (EU) 2019/879 of 20 May 2019 amending Directive 2014/59/EU, OJ L 150/296, 7.6.19, p. 296-344. For convenience, in this note 'BRRD2' designates the consolidated BRRD following the adoption of Directive (EU) 2019/879.

⁴ Regulation 2019/877 of 20 May 2019 amending Regulation (EU) No 806/2014, OJ L 150/26, 7.6.19, p. 226-252. For convenience, in this note 'SRMR2' designates the consolidated SRMR following the adoption Regulation 2019/877.

⁵ [Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution - Total Loss-absorbing Capacity \(TLAC\) Term Sheet](#).

⁶ TLAC and MREL eligible instruments' eligibility criteria are very similar, with a few exceptions, the main one being subordination. As stated in recital (16) of CRR2 and recital (2) of BRRD2, 'as the TLAC standard and the MREL pursue the same objective of ensuring that institutions have sufficient loss absorption capacity, the two requirements should be complementary elements of a common framework'. Moreover, 'the provisions introducing the TLAC standard in Regulation (EU) No 575/2013 should be read together with the provisions that are introduced into Directive 2014/59/EU and Regulation (EU) No 806/2014, and with Directive 2013/36/EU'.

⁷ Regulation (EU) 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. 12-47.

tools, including sufficient resources, are available and allow the institution or the group to be resolved in an orderly, cost-efficient and timely manner’.

5. More generally, in accordance with Article 32(1) of the EBA Regulation, ‘the Authority [EBA] shall monitor and assess market developments in the area of its competence and, where necessary, inform EIOPA, ESMA, the ESRB, the European Parliament, the Council and the Commission about the relevant micro-prudential trends, potential risks and vulnerabilities’.
6. It may be recalled that, apart from the monitoring of TLAC/MREL- eligible⁸ liabilities instruments issuances, the EBA also monitors hybrid capital issuances and has published its last version of the AT1 report in June 2021⁹. In addition, the EBA maintains and publishes a list of Common Equity Tier 1 (CET1) instruments issued by institutions in the EU. This list was most recently published on 8 December 2021¹⁰. The list is accompanied with a CET1 monitoring report¹¹ most recently updated on 8 December 2021.
7. The present report constitutes an updated version of the inaugural report published in October 2020¹². Since the publication of the first report, the EBA has continued to monitor new issuances and has found that there are a few new notable provisions to be recommended or avoided.
8. To perform its monitoring function, the EBA has focused its work on the assessment of selected TLAC/MREL- eligible liabilities instruments. For this report, the scope of the monitoring included senior non-preferred (SNP) issuances, senior holding company issuances and senior preferred (SP) MREL eligible liabilities.
9. Furthermore, the EBA received input during a roundtable held with stakeholders in July 2022 regarding the ongoing review of the quality of TLAC/MREL-eligible liabilities instruments. There was broad support expressed for the preliminary observations presented by the EBA during the roundtable.
10. While this report provides current policy views based on TLAC/MREL- eligible liability instruments assessed up to February 2022, the monitoring of new issuances will continue, with the objective of covering as many jurisdictions as possible and enriching the observations and recommendations going forward.
11. While the main focus of this report is on TLAC/MREL- eligible instruments, some findings or recommendations might be relevant for own funds instruments, in particular Tier 2 ones. It is also stressed that this report has been brought in line with findings/recommendations included in the above-mentioned AT1 report where appropriate.

⁸ [EBA TLAC MREL monitoring report October 2020](#)

⁹ [EBA AT1 report June 2021](#)

¹⁰ [EBA updates on monitoring of CET1 capital instruments | European Banking Authority \(europa.eu\)](#)

¹¹ [CET1 report](#)

¹² [EBA issues first monitoring report on TLAC-MREL instruments accompanied by 15 recommendations | European Banking Authority \(europa.eu\)](#)

12. The EBA findings contain policy views on existing or new provisions, together with identified best practices. The report also provides an insight into areas for scrutiny/monitoring or potential EBA guidance going forward.
13. Similarly to the EBA efforts on own funds instruments, this monitoring exercise aims to assess the application of the eligibility criteria and provide best practices and recommendations. It is not meant to analyse the final compliance of any given instrument, which will be determined by the relevant resolution authority in consultation with the competent authority. This is particularly because some of the eligibility criteria (such as the absence of excluded liabilities on the balance sheet ranking *pari passu* to or below eligible liabilities of a holding company in the event of structural subordination) cannot be checked solely on the basis of the contractual documentation.
14. In performing its monitoring function, the EBA ensured consistency with its other connected mandates, such as the draft technical standards on direct and indirect funding, incentives to redeem, and the conditions and procedures for authorising institutions to redeem eligible liabilities instruments¹³ published in May 2021.

Content of the report and main findings

15. The EBA seeks to ensure consistency, where appropriate, across instruments with similar loss absorbency features, taking into consideration the fact that the aim of TLAC/MREL is not limited to loss absorption, but is also for recapitalisation purposes or to support the implementation of other resolution tools.
16. There has been a continued anticipation of regulatory objectives and requirements. To reach the MREL targets at the end of the corresponding transition periods, banks issued approximately EUR 93 billion of SNP/senior holding company debt in 2020 and EUR 86 billion in 2021 according to public data sources.
17. The following observations on the monitored issuances are noteworthy:
 - The peculiarity of the TLAC/MREL monitoring work is that most of the necessary information is found in the MTN programmes, whereas the term sheets themselves are very concise. This contrasts with some own funds issuances, where their terms and conditions are quite detailed and can be analysed on a stand-alone basis.
 - Since its first report, the EBA has observed a substantial increase in new SNP issuances from jurisdictions where no issuers had issued previously and from smaller (lower rated) issuers in other jurisdictions. All in all, issuances of SNP instruments have now been made in 19 EU jurisdictions.
 - An increased number of Green or Social label TLAC/MREL- eligible liability instruments have been observed from 2021 and onwards. All issuances were 'use of proceed' ESG bonds

¹³ [Final Report on draft RTS on OFs and ELs.pdf \(europa.eu\)](#)

whereby the net proceeds are used primarily towards the financing or refinancing eligible Green or Social assets. Issuances made after the EBA recommendations on ESG bonds for regulatory purposes published via the latest update of the AT1 report¹⁴ have integrated these recommendations.¹⁵

- The trend towards moving from dual governing laws to one single governing national law, following the United Kingdom leaving the EU has continued. Institutions have also been encouraged to consider issuing under the governing laws of the EU-27 Member States by some resolution authorities.
 - The issue price for most issuances analysed was generally at par or slightly below par. Most notes in the sample mature after 5 or 6 years, but some range from 3 years to 10 years. Compared to the start of the EBA monitoring, inclusion of calls (generally one year before final maturity) has become more standard practice. Issuances continue to include regulatory and tax calls. Issuances continue not to include discretionary put options (held by the investor), which is welcome.
18. The EBA has focused mainly on the analysis on SNP, senior preferred MREL eligible notes and senior holding company instruments. Compared to when the EBA started its monitoring, SNP issuances are now generally statutorily subordinated, and not anymore contractually subordinated due to the transposition of Directive (EU) 2017/2399¹⁶ into national law. This trend is expected to continue.
19. The EBA observes that, so far, in terms of legal drafting of the notes and programmes, market participants continue to use simple and standardised provisions. This is conducive to legal certainty and reliability at the point of resolution. This convergence and standardisation are probably also due to the experience gained with AT1 instruments' clauses and EBA past guidance. Issuances typically include provisions that are not per se required by the eligibility criteria but are common in own funds issuances (regulatory and tax calls in particular).
20. In general, the contractual provisions of TLAC/MREL- eligible liability instruments have shown to be less complex than those of own funds instruments. The main areas in which the EBA provides observations relate to availability, subordination, capacity for loss absorption, maturity, and other aspects (for example governing law and tax and regulatory calls).

Main observations

21. The main observations are as follows:

¹⁴ [Part 4 in AT1 report](#)

¹⁵ The part on Environmental, social and governance bonds included in the previous version of the TLAC / MREL monitoring report published on 29 October 2020 has been removed given that the additional guidance foreseen at that time has been published via the AT1 monitoring report published on 24 June 2021.

¹⁶ Directive (EU) 2017/2399 of the European Parliament and of the Council of 12 December 2017 amending Directive 2014/59/EU as regards the ranking of unsecured debt instruments in insolvency hierarchy, OJ L 345, 27.12.2017, p. 96-101.

Availability

22. Generally, the notes are issued by the resolution entity itself and the contractual documentation includes a reference that notes have been fully paid up. Nevertheless, availability criteria can generally not be verified solely on the basis of the contract. A complementary analysis may be warranted to establish that the issuing entity is a resolution entity or that the holders are not themselves resolution group entities or funded by the resolution group.¹⁷

Subordination

23. The main areas covered in this section include the different types of subordination, namely (i) contractual subordination, (ii) statutory subordination and (iii) structural subordination, as well as aspects related to subordination of principal and interest, ranking of SNP notes (as they sit at an intermediary level between common subordinated notes and ordinary unsecured notes) as well as some 'flipper' clauses.

The recommendations include the following:

24. Issuers should set out unambiguous terms on the ranking of notes in insolvency, and there should be no doubt that the notes are subordinated to statutory excluded liabilities. A description of instruments ranking junior and senior to a note under consideration constitutes best practice, particularly if the note is not statutorily subordinated as a result of Article 108 of the BRRD, as amended by the Creditor Hierarchy Directive.
25. Subordination of interest to excluded liabilities is not imposed, as per the CRR, as an eligibility criterion. However, there should always be clarity, in the MTN programmes terms and conditions of the bonds of the ranking of interest. In addition, as many transactions already have this subordination of interest in place, the EBA previously expressed the view that this could be seen as best practice when this is compatible with the creditor's hierarchy according to national insolvency law. It appears that this guidance has now become even more of a market standard, and EBA expects that this trend will continue going forward.
26. Statutory subordination: in addition to referring to the applicable transposition of the Creditor Hierarchy Directive, a clear description of where the notes sit in the national hierarchy is conducive to additional clarity.
27. If notes are structurally subordinated, best practice consists of clarifying, for investor awareness purposes, the structural subordination mechanism, and related risks (for example, via the risk factors in the contractual documentation).

¹⁷ Article 45f BRRD requires entities which are not a resolution entity to issue own funds to any entity in the resolution group, and eligible liabilities directly or indirectly to the resolution entity. The eligibility criteria set out in Article 45f(2) BRRD, are almost identical to or cross-referred to the eligibility criteria applying to externally issued MREL/TLAC (Articles 72a and 72b CRR). The main difference is the issuance pattern since, unlike external MREL/TLAC which must be issued to external investors, internal MREL needs, to fulfil its aims, to be issued directly or indirectly to the resolution entity.

Capacity for loss absorption

28. This section includes an analysis of the clauses on set-off and netting, acceleration of the interest and principal payments of the notes, interest and dividend, write-down and conversion and negative pledges.

The recommendations include the following:

29. Eligibility requires that the liability is not subject to set-off or netting arrangements that would undermine capacity to absorb losses. Although an explicit waiver of set-off and netting rights is not a legal requirement and the absence of such a clause does not lead the concerned instrument to be grandfathered and ultimately disqualified, such an explicit waiver is conducive to legal certainty, and in the light of market practice is seen as best practice. EBA has conducted a comprehensive survey on the existence of statutory set-off and netting rights, which are present in all 27 jurisdictions. Due to the fact that the set-off and netting rights set out in civil laws, consumer protection laws and insolvency laws are not harmonised under EU law, these rights vary substantially from jurisdiction to jurisdiction, nevertheless in the vast majority of the member states a waiver of these rights is effective. That said, resolution authorities have a monitoring role to play on how set-off and netting rights would work in practice under the respective national laws. The EBA will continue to liaise with resolution authorities in this respect.
30. Reference to a compensatory payment in the terms and conditions of the notes from the holder in case an amount due to the issuer is unduly discharged as a result of netting or set-off can be seen as best practice.
31. It should follow unambiguously from the notes that acceleration can occur only on the ground of insolvency or liquidation, and that, in particular, it cannot occur in resolution (or a moratorium).
32. The AT1 standardised templates recommends standard drafting for bail-in clauses under Article 55 of the BRRD. A similar effort could be envisaged in relation to eligible liabilities to ensure compliance with Article 55 of the BRRD as well as Article 72b(2)(n) of the CRR.
33. A clause to the effect that delay or failure by the issuer to notify the noteholders must not affect the validity and enforceability of the bail-in or write-down and conversion powers is considered best practice.
34. Explicit exclusion of negative pledges is seen as a best practice.

Maturity

35. This section includes an analysis of the clauses on call and put options, incentives to redeem and supervisory approval for early redemption.

The recommendations include the following:

36. The EBA has investigated the possible use of make-whole provisions that allow an issuer to redeem a bond prior to maturity on the basis of a make-whole redemption amount representing the present value of the principal amount and remaining interests. While make-whole clauses might not always be automatically considered as an incentive to redeem, they would always increase the amount ultimately redeemed at the call date compared to par, and in some cases to a higher cost of the issuance. They are seen as complex features, which do not bring any additional prudential value. In this context, the EBA welcomes the prudent approach retained to date by European issuers and is of the view that these clauses should not be included for own funds and eligible liability instruments. Issuers should use par calls instead.
37. The EBA also received questions on the compliance of instruments including 'clean-up clauses', i.e. a call option that would allow the issuer to redeem the outstanding notes in the situation where a specified threshold (measured against the initial amount) of instruments is redeemed. In this context, the EBA considers that 'clean-up clauses' are acceptable in the terms and conditions of own funds and eligible liabilities under certain conditions. In particular, the 'clean-up clause' should always be linked to an action referred to in Article 77(1) of CRR which has been subject to a competent authority's prior permission or Article 77(2) of the CRR which has been subject to a resolutions authority's prior permission, which is still valid, independently of the exact timing of the exercise of the 'clean-up clause'.
38. The EBA will continue to monitor the wording of options carefully, especially for put options that are not exercised on the initiative of the issuer, to ensure that put options cannot be exercised at any time, in which case the instrument would not be considered eligible. To date, no holders put option provisions have been observed in the issuances reviewed, which is welcome.
39. In terms of incentives to redeem, Article 20 of the RTS on own funds and eligible liabilities has brought alignment between own funds and eligible liabilities. Similarly, guidance that might be further developed by the EBA in the future will preserve this alignment.
40. An explicit reference to the requirement to obtain the prior permission for any call, redemption, repayment or repurchase from resolution authorities for reductions in eligible liabilities is necessary, as for own funds' instruments. However, this kind of provision only fully achieves its purpose if it is precisely drafted; vague terms such as 'to the extent required' or the 'relevant regulator' should be avoided now that the legislative framework has been finalised.

Other aspects

41. In this section, the EBA assessed governing law, tax and regulatory calls, and tax gross-up clauses.

The recommendations include the following:

42. Consistent with the own funds framework, tax gross-up should be accepted only under certain conditions, as applicable to eligible liabilities instruments, i.e. gross-up clauses can be

considered acceptable if they are activated by a decision of the local tax authority of the issuer, and if they relate to interest and not to principal.

43. Both for eligible liabilities instruments and own funds instruments, substitution and variation clauses, whose purpose is to ensure compliance with the regulatory eligibility criteria, should as a minimum, be subject to receiving the prior consent of the relevant authority (the reference to consent being adapted to local specificities, i.e. this might mean a prior approval under Article 77 of CRR in some jurisdictions). Furthermore, where these clauses would lead to material changes that would affect the eligibility criteria of the instruments, their exercise should always be subject to the prior approval (under Article 77 of CRR) of the relevant authority.

EBA's considerations on TLAC/MREL-eligible liabilities monitoring

44. This part covers the following main topics in detail: availability, subordination, capacity for loss absorption, maturity and other aspects.

A. Availability

45. Article 72b(2) of the CRR requires eligible liabilities instruments to be (i) directly issued or directly raised¹⁸ and fully paid up, (ii) not owned by an entity in the same resolution group or an undertaking in which the institution has direct or indirect participation, and (iii) not funded directly or indirectly by the resolution entity. Article 72b(2)(e) of the CRR requires that the liabilities are neither secured nor subject to a guarantee or any other arrangement that enhances the seniority of the claim. The EBA technical standards on own funds and eligible liabilities¹⁹ specify the applicable forms and nature of indirect funding of liabilities.

46. The availability criteria, also applicable to own funds²⁰, aim to provide genuine loss-absorbing capacity to the institution. Inter alia, if the instrument was issued within the resolution group, it would only reallocate losses rather than provide fresh capital at the point of failure.

47. Eligible liabilities instruments should be issued by the entity that is subject to the requirement, i.e., in the case of (external) TLAC/MREL, a resolution entity. By derogation, liabilities issued by a subsidiary established in the Union that belongs to the same resolution group as the resolution entity must qualify for inclusion in the consolidated eligible liabilities instruments of an institution under the conditions of Article 88a of the CRR (for TLAC) and Article 45b(3) of the BRRD (for MREL). In essence, this concerns liabilities issued to an existing shareholder, the conversion of which would not affect the control of the subsidiary by the resolution entity.²¹

48. MTN programmes and/or terms and conditions usually provide indications related to availability criteria, stating that notes constitute direct, unconditional and unsecured obligations of the issuer. Nevertheless, availability criteria can generally not be verified solely on the basis of the contract. For example, a complementary analysis may be warranted to

¹⁸ In limited circumstances, Articles 88a of the CRR and Article 45(b)3 of the BRRD allow liabilities issued by subsidiaries to existing shareholders to count towards the eligible liabilities of the resolution entity under some conditions. In summary, the liabilities must be issued from a subsidiary inside the resolution group to an existing shareholder outside the resolution group; the exercise of write-down or conversion powers must not affect the control of the subsidiary by the resolution entity. These conditions aim to ensure that the presence of externally issued liabilities at the subsidiary level will not affect the direct or indirect control of the resolution entity in the event of write-down and conversion.

¹⁹ [RTS on own funds and eligible liabilities](#)

²⁰ Note that Articles 52 and 63 have been amended by CRR2 to also require direct issuance in the case of AT1 and Tier 2. The condition was already set out in relation to CET1 in Article 26 of the CRR.

²¹ Please see FN 19 (para 22) concerning internal MREL.

establish that the issuing entity is a resolution entity or that the holders are not themselves resolution group entities.

49. In relation to the requirement for the notes not to be secured by a branch of the institution issuing the liability, the EBA, in [Q&A 2016_2966](#), assessed that debt securities issued under Section 3(a)(2) of the United States Securities Act of 1933 and, accordingly, guaranteed by a branch of an EU institution should not be considered eligible as MREL from the point of view of that institution. Since the publication of that answer, some stakeholders have conveyed to the EBA the view that such guarantees do not ‘enhance the seniority of the claim’ within the meaning of Article 72b(2)(e) of the CRR whereby investors have contractually waived their right to execute the guarantee. However, it remains that such arrangements set out a complex articulation between strict procedural requirements for the marketing of notes under US law, a restrictive range of exemptions to those requirements under strict conditions, and contractual provisions to rely on the exemption to marketing requirements while bypassing the conditions thereof. In addition, considering the fact that the relevant provisions are governed by third country law, which the EBA is not competent to interpret, the EBA does not see a reason, at this stage, to change the existing position expressed in the Q&A. That said, the EBA will continue to exchange views with stakeholders on this aspect.
50. The assessment above is without prejudice to notes that are issued under US law but under different grounds, such as ‘Rule 114A’ concerning notes distributed to qualified institutional buyers to the extent that they are not guaranteed.

B. Subordination

51. Pursuant to Article 72b(2)(d) of the CRR, eligible liabilities instruments may only be eligible provided that the claim on the principal amount is ‘wholly subordinated to claims arising from the excluded liabilities’ referred to in Article 72a(2) of the CRR. Three types of subordination are admitted in points (i) to (iii):
- (i) Contractual subordination: this refers to notes subordinated to claims arising from any of the excluded liabilities referred to in Article 72a(2) of the CRR as a result of the contract.
 - (ii) Statutory subordination: this refers to notes subordinated to claims arising from any of the excluded liabilities referred to in Article 72a(2) of the CRR as a result of applicable law.

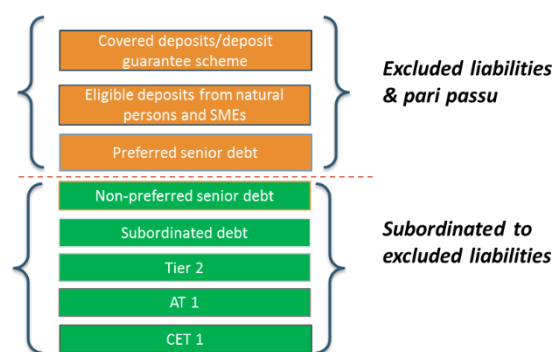
For example, Article 108 of the BRRD, as amended by the Creditor Hierarchy Directive, introduces a harmonised level of statutory subordination in all Member States by providing for an intermediary ranking between subordinated claims and ordinary unsecured claims, and therefore meeting, depending on the national insolvency applicable regime, in principle the subordination criteria of Article 72b(2)(d)(ii) of the

CRR. Senior non-preferred claims must refer to the intermediary ranking under the new provision.

By convention, the EBA designates as ‘statutorily subordinated’ instruments, the ranking of which in the event of normal insolvency proceedings is mandatorily governed by legislation, even if the decision to elicit that insolvency ranking is provided for in the contract. Along with the transposition of the Creditor Hierarchy Directive by EU jurisdictions, statutory subordination has progressively replaced contractual subordination.

- (iii) Structural subordination: this refers to notes issued from a resolution entity that does not have on its balance sheet any excluded liabilities referred to in Article 72a(2) of the CRR that rank *pari passu* with or junior to eligible liabilities instruments.
52. Issuers should set out unambiguous terms on the ranking of notes in insolvency, and in particular there should be no doubt that the notes are subordinated to excluded liabilities within the meaning of Article 72a(2) of the CRR. A description of instruments ranking junior and senior to a note under consideration constitutes best practice, particularly if the note is not statutorily subordinated as a result of the application of the national measures implementing Article 108 of the BRRD, as amended by the Creditor Hierarchy Directive.

Figure 1.: Simplified stack - statutory subordination for the purpose of MREL



53. In general, senior non-preferred notes rank below in insolvency with liabilities excluded pursuant to Article 72a(2) CRR, meaning they meet the subordination criterion in Article 72b(2)(d) CRR. Also, Recital 10 of the BRRD provides that “Member States should be allowed to create several classes for other ordinary unsecured liabilities provided that they ensure, without prejudice to other options and exemptions provided for in the TLAC standard, that only the non-preferred senior class of debt instruments is eligible to meet the subordination requirement.”. However, Articles 72b(3) to (5) of the CRR permit senior preferred liabilities also to qualify as eligible liabilities instruments, under the conditions specified therein and up to a certain ceiling. In addition, according to Article 45b of the BRRD senior preferred liabilities also may count towards the MREL requirement in principle, however the resolution authority may impose a minimum subordination requirement to institutions. On the status of the notes,

the EBA has observed that some programmes define the MREL eligible senior notes as a category separately identified, while others do not provide for any differentiation with other senior notes. EBA will continue monitoring market practices on MREL eligible senior notes going forward.

Contractual subordination

54. When it comes to contractual subordination other than by reference to SNP legislation, the question of how subordination should be defined arises. Indeed, notes classically define subordination by reference to a higher class, such as ‘senior notes’. However, the notion of subordination for the purpose of the CRR is not defined in terms of commonly defined class but in terms of subordination to ‘claims arising from ... excluded liabilities²²’ (Article 72b(2)(d) of the CRR). In this regard, when faced with a note that specifies that it is subordinated to senior claims or ranks *pari passu* with senior non-preferred claims, one could wonder if it is without any doubt subordinated to excluded liabilities. As a conclusion, explicit language mentioning subordination ‘to excluded liabilities’ within the meaning of the CRR could achieve legal certainty if banks rely purely on contractual subordination.

Statutory subordination

55. Subordinated notes are generally subordinated under statutory terms and mention a national law transposing the Creditor Hierarchy Directive. Statutorily subordinated notes do not only cross-refer to the SNP legislation but also usually proceed to describe the senior non-preferred ranking in the hierarchy of claims. In general, notes extend the subordination status to both principal and interest and therefore go beyond Article 72b(2)(d) of the CRR, which refers only to the principal. In rare cases the provisions used might give the impression that interest claims are more subordinated than principal claims. Clarity on the status of both principal and interest is welcome.
56. As SNP notes sit at an intermediate level between common subordinated notes and ordinary unsecured notes, practice varies as to whether or not SNP notes are presented as a specific subcategory of notes with senior status (this is the case for most base prospectuses) or as a stand-alone category between senior and subordinated. Some prospectuses present the notes as being ‘unsubordinated’ – which is counterintuitive, as SNP is meant to ensure a form of resolution-driven subordination – but they explain that SNP notes are in fact senior to classic forms of subordinated debt. This is confirmed by other notes that describe themselves as being senior to ‘ordinarily subordinated’.
57. In principle, unless otherwise specified under national insolvency frameworks, reference to SNP legislation should give a clear description of where the notes sit in the hierarchy of claims and should not raise any doubt that those liabilities are genuinely subordinated to ‘excluded liabilities’ within the meaning of Article 72a(2) of the CRR. This is because Article 108 of the

²²Excluded liabilities are listed in Article 72a(2) of the CRR and essentially cover non-bail-inable liabilities, which may in certain cases also be exempt from losses in liquidation, for example covered deposits and secured liabilities.

BRRD has been especially amended by the Creditor Hierarchy Directive, with a view to meeting subordination criteria for eligible liabilities instruments. Nonetheless, from the moment that notes do attempt to describe the ranking of SNP notes, they would ideally also make clear that the notes are ‘wholly subordinated to claims arising from the excluded liabilities within the meaning of Article 72a(2) of the CRR’, as seen in some contractual documentation taking into account the 3rd subparagraph of Article 72b(2) of the CRR²³. In this regard, the EBA believes that labelling SNP as ‘unsubordinated’ could be misleading and it would be preferable to simply describe and clearly state the status on how they rank vis-à-vis senior unsecured and other subordinated debt. It is considered also it is clearer to investors if SNP were presented as a stand-alone category, rather than as a subcategory of senior notes.

58. Having interest subordinated to excluded liabilities is not a CRR eligibility criterion. However, the ranking of interest is an important issue, as interest can only be counted towards the loss absorption capacity of the bank if it is subordinated and, as per Article 72c(1) of the CRR, has a residual maturity of at least 1 year. In addition, as per Article 108 of the BRRD (as amended by the Creditor Hierarchy Directive), debt instruments with variable interest derived from a broadly used reference rate and debt instruments not denominated in the domestic currency of the issuer, provided that principal, repayment and interest are denominated in the same currency, must not be considered to be debt instruments containing embedded derivatives solely because of those features. Given this, there should always be clarity in the terms and conditions of the bonds of the ranking of interest in the insolvency hierarchy. Furthermore, interest subordination can be seen as best practice for subordinated instruments when this is compatible with the creditor’s hierarchy according to national insolvency law. It appears, based on the issuances analyses following the publication of the first TLAC/MREL monitoring report, that best practice has become market standard.

Structural subordination

59. In the event of structural subordination, subordination does not stem from contractual or legal provisions that would govern the respective ranking of investors in the entity. Instead, in this configuration, excluded liabilities are essentially located at a lower level in the group in a separate entity. In the event of bail-in at the level of the parent issuer (identified as resolution entity), creditors of the issuer will absorb losses first. The notes issued by the parent issuer are thus labelled ‘senior’ but are in effect structurally subordinated to all (excluded and other) liabilities of subsidiaries. This structural subordination is provided if there are effectively no excluded liabilities ranking junior to or *pari passu* with MREL-eligible liabilities instruments on the balance sheet of the parent issuer, or for non-significant amounts of such liabilities ranking *pari passu* or junior (less than 5% of the amount of the own funds and eligible liabilities of the institution) where the conditions under Article 72b(4) of the CRR are fulfilled.

²³ For the purposes of point (d) of the first subparagraph of this Article, where some of the excluded liabilities referred to in Article 72a(2) are subordinated to ordinary unsecured claims under national insolvency law, inter alia, due to being held by a creditor who has close links with the debtor, by being or having been a shareholder, in a control or group relationship, a member of the management body or related to any of those persons, subordination shall not be assessed by reference to claims arising from such excluded liabilities.

60. For this type of subordination, the analysis of eligibility depends not on the formal insolvency ranking set out in the note but on the actual liability structure of the entity and the issuance of subordinated internal MREL at the level of operating subsidiaries. This means that, purely on the basis of the notes, it might be difficult to conclude that the issuing entity is ‘clean’ from excluded liabilities and that the liabilities are structurally subordinated to the operating liabilities of the subsidiaries. The contractual documentation might explicitly state that the notes are structurally subordinated to the operating liabilities of the subsidiaries.
61. Such a statement acknowledging the structural subordination to creditors in subsidiaries appears to be best practice, as it clarifies the intended status of the note vis-à-vis investors and authorities and provides high-level information on the liability structure.
62. Nevertheless, this kind of statement does not in itself solve the question of whether or not the notes meet the CRR subordination criteria, because it does not guarantee that, within the balance sheet of the holding company, no excluded liabilities rank or will rank junior to or *pari passu* with the issued note. Therefore, reaching a conclusion on eligibility necessitates precise information on the presence of excluded liabilities on the balance sheet and on their relative ranking vis-à-vis eligible liabilities. A best practice would be clarifying, for investor awareness purposes, the structural subordination mechanism and risks. This may, for example, be described in the risk factors and does not imply that the notes should be contractually subordinated. The assessment is also time dependent, as the liability structure of the entity may also evolve after the issuance.
63. It is the responsibility of institutions to ensure compliance at all times, under the surveillance of resolution authorities in cooperation with competent authorities and following the relevant reporting requirements as specified by the implementing technical standards for the application of Regulation (EU) No 575/2013 with regard to the supervisory reporting and public disclosure of the minimum requirement for own funds and eligible liabilities²⁴.

‘Flipper’ bonds

64. When starting its monitoring before the enactment of a statutory SNP regime in the relevant jurisdiction, the EBA has observed a few flipper clauses that were meant to automatically convert the ranking of the notes from either contractual subordination or senior ranking to statutory subordination from the entry into force of the national SNP legislation.
65. Some MTN programmes might also provide a mechanism for notes to convert from ‘senior preferred’ to ‘senior non-preferred notes’. Two different possibilities are provided: either an optional conversion triggered by a notice given by the issuer or an ‘automatic conversion’ triggered by the occurrence of an ‘automatic conversion date’ to be set out in the applicable supplement. In both cases (automatic and optional conversion), the MTN specifies that a conversion does not constitute an event of default.

²⁴ [ITS for supervisory reporting and public disclosure of Own Funds and Eligible Liabilities](#)

66. Preliminarily, flipper clauses were conducive to the quality of eligible liabilities instruments, since they increase the level of subordination or elicit a statutory regime that has been designed on purpose to meet TLAC/MREL subordination. Until the moment that the notes are converted, they should be analysed under their current regime, for example a senior ranking or contractual subordination. From the point of conversion, considering the fact that investors were informed and agreed to be bound by the conversion ex ante, such conversion should not in principle be considered prejudicial to the interests of the noteholders, even though the conversion might downgrade the claim in the insolvency hierarchy of claims.
67. In the case of optional or automatic conversion, the EBA assessed that, in principle, this should not be problematic, as long as all eligibility criteria are or continue to be met at the point of conversion. However, there must be no ambiguity about the fact that, if it is not guaranteed that the eligibility criteria are or continue to be met at the point of conversion, the instruments should not be qualified or should be disqualified as TLAC-/MREL-eligible instruments respectively. Furthermore, in one case the national law implementing the SNP directive explicitly provided for the recognition of flipper clauses, which should be seen as an additional element of certainty.

C. Capacity for loss absorption

Absence of set-off or netting arrangements

68. In accordance with Article 72b(2)(f) of the CRR, 'liabilities shall not be subject to set-off or netting arrangements that would undermine their capacity to absorb losses in resolution'. In general, set-off and netting is not permitted in an insolvency proceeding, unless certain requirements for set-off and netting have been met prior to the insolvency declaration and comply with specific national insolvency legislation.
69. As a standard practice, issuances contain a clause to the effect that set-off or netting rights are waived. MTNs sometimes also contain a backstop provision whereby, if an amount payable by the issuer in respect of any note to any holder is discharged by set-off or any netting, the holder must pay an amount equal to the amount of such discharge to the issuer, and the discharge must be deemed not to have taken place.
70. In general, the language found in the contractual terms of the issuances reviewed to date is clear and precise on the waiving of set-off or netting rights by the holder. However, in some cases word 'counter-claim' is used instead of 'netting'. However, in some of the provisions assessed, the terminology used does not mirror the one provided in the CRR and the BRRD. As a best practice, the wording used should be, where possible, in accordance with that in the CRR and BRRD.
71. As clarified in recital (26) of CRR2 the prohibition of set-off and netting rights 'should not mean that the contractual provisions governing the liabilities should contain a clause explicitly stating that the instrument is not subject to set-off or netting rights'. Although this is not a

legal requirement and the absence of such a clause does not mean that the instrument concerned needs to be grandfathered and ultimately disqualified as eligible liabilities as explained in [Q&A 2020 5146](#), an explicit waiver of set-off and netting rights seems to be conducive to legal certainty, and, in the light of market practice, a recommendation to include such a waiver is seen as best practice and would reportedly meet market expectation. Furthermore, for the backstop provision foreseeing a compensatory payment from the holder in case an amount due to the issuer is nevertheless unduly discharged as a result of netting or set-off is seen as best practice, where this is compatible with national law.

72. The EBA has further monitored the interaction between contractual clauses in the terms and conditions of the issuances and the provisions of the relevant national laws, in particular to form a view on clauses referencing to national laws as a possible limitation to the effectiveness of the absence of netting and set-off. It appears that in the very vast majority of EU jurisdictions, set-off and netting rights can be waived effectively. However, in some jurisdictions there might be specific circumstances (insolvency) or certain parties (consumers) for which statutory set-off or netting rights cannot be waived contractually. There is much uncertainty given the lack of case law. In a couple of jurisdictions these limitations explicitly do not apply to institutions, which can be considered as the most transparent way forward to clarify this interaction.
73. It is for resolution authorities to monitor how set-off and netting rights would work in practice under the respective national laws and assess how to resolve at best any potential issue in this respect. The EBA will continue to liaise with resolution authorities in this respect.

No right for holder to accelerate the payment of interest or principal

74. Article 72b(2)(l) of the CRR requires that ‘the provisions governing the liabilities do not give the holder the right to accelerate the future scheduled payment of interest or principal, other than in case of the insolvency or liquidation of the resolution entity’.
75. In spite of the broadness of the term ‘insolvency or liquidation’, which can receive different definitions under national law, this requirement should be understood as precluding acceleration in any circumstances other than an insolvency proceeding, including insolvency liquidation but excluding resolution proceedings.
76. Indeed, the purpose of this prohibition is to make sure that instruments can play their role in resolution, i.e. to absorb losses of an institution that is failing or likely to fail so that resolution authorities can maintain, inter alia, critical functions. This purpose would be defeated if counterparties could claim an anticipated payment on the ground that the institution is undergoing resolution or is subject to a moratorium. The situation is different when a bank is put under ‘normal insolvency proceedings’²⁵ (also known as liquidation) leading to the

²⁵ See Article 2(1)(47) of the BRRD: the term ‘normal insolvency proceedings’ means collective insolvency proceedings that entail the partial or total divestment of a debtor and the appointment of a liquidator or an administrator normally applicable to institutions under national law and either specific to those institutions or generally applicable to any natural or legal person.

discontinuation of the activities of the institutions. In normal insolvency, acceleration is not problematic, because it does not cause the bank to pay any amount to the counterparty but renders the liability due and enables the counterparty to file its claim with the insolvency estate.

77. In the same vein, Directive 2001/24/EC²⁶ on the reorganisation and winding up of credit institutions, which sets out intra-EU cross border recognition of insolvency proceedings of credit institutions, distinguishes between ‘reorganisation measures’, which are ‘intended to preserve or restore the financial situation of a credit institution’ and ‘winding up measures’, which means the ‘realisation of assets of an institution’. When the BRRD was adopted in 2014, Directive 2001/24/EC was explicitly amended to specify that reorganisation measures ‘include the application of the resolution tools and the exercise of resolution powers’.
78. Issuances generally contain clauses according to which acceleration rights are granted to the noteholders in the case of ‘liquidation’, ‘winding-up’ or ‘bankrupt[cy]’ of the issuer. The terms vary, as insolvency terminology is different from one Member State to another and considering the fact that, as recital (45) of the BRRD recalls, ‘a failing institution should in principle be liquidated under national insolvency proceedings’. That said, resolution is not always explicitly excluded from the grounds for acceleration in the documentation, and in this case the eligibility assessment of those clauses is dependent on the assumption that the procedures described above cannot be understood as comprising resolution. In this regard, it should be clear from the notes that acceleration can occur only on the ground of insolvency or liquidation, and that, in particular, it cannot occur in resolution or a moratorium under the BRRD²⁷. A best practice would be that ‘resolution’ and ‘moratorium’ are mentioned explicitly by the notes as not giving rise to acceleration.

Level of interest or dividend not amended based on credit standing

79. Article 72b(2)(m) of CRR2 requires that ‘the level of interest or dividend payments, as applicable, due on the liabilities is not amended on the basis of the credit standing of the resolution entity or its parent undertaking’.
80. The EBA did not observe provisions amending the level of interest or dividend payment on the basis of the credit standing of the resolution entity or its parent undertaking. The MTNs or final terms usually foresee a fixed coupon, a floating rate or a combination thereof, with an automatic conversion from fixed interest to a floating rate at a given date.

²⁶ Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding up of credit institutions.

²⁷ See Article 33a of the BRRD.

Write-down and conversion clauses (bail-in clauses)

81. Article 72b(2)(n)²⁸ of the CRR requires the relevant contractual documentation and, if applicable, the prospectus to explicitly refer to the possible exercise of the write-down and conversion powers in accordance with Article 48 of the BRRD. Such write-down and conversion, triggered upon intervention of the resolution authority in the context of the bail-in tool, must not be confused with automatic (i.e. without authorities' intervention) write-down and conversion at the 'trigger event' within the meaning of Article 54 of the CRR for AT1 instruments.
82. MTNs programmes generally provide contractual language whereby noteholders acknowledge, accept, consent to, and agree to be bound by bail-in and include a reference to the exercise of write-down and conversion powers by the relevant resolution authority, although the requirement in Article 72b(2)(n) of the CRR only applies to instruments issued after 28 June 2021.
83. In addition, Article 55 of the BRRD requires instruments governed by third country law to include a contractual term by which the creditor or party recognises that the liability may be subject to the write-down and conversion powers and agrees to be bound by any reduction in the principal or outstanding amount due, conversion or cancellation that is affected by the exercise of those powers by a resolution authority. The requirement may be subject to exemption or may not be applicable if either (i) the effectiveness of the bail-in is achievable through the law of third countries or binding agreements concluded with the third country, or (ii) the resolution authority agrees that the inclusion of the contractual recognition meets the conditions of impracticability or is illegal, as notified by the institution. However, in the latter case the instrument cannot count towards MREL, in accordance with the last subparagraph of Article 55(2) of the BRRD.
84. In relation to Article 55 of the BRRD (in its versions prior to its amendment by BRRD2), the EBA has provided guidance in the past and has also suggested model recognition clauses ([AT1 report](#), paragraphs 65-77²⁹, AT1 standardised template October 2016). For example, the EBA highlighted that those contractual terms should 'not give the impression that a write-down (or conversion) notice has to be given to investors before the institution can write-down (or convert) the instrument (precondition)'.
85. Article 55 of the BRRD requires an 'explicit recognition' of bail-in powers and that the creditor or party to the agreement or instrument 'agrees to be bound by any reduction of the principal or outstanding amount due, conversion or cancellation', whereas Article 72b(2)(n) of the CRR, provides for an 'explicit reference' to the possible exercise of the write-down and conversion powers. To ensure MREL and TLAC eligibility, the terms and conditions governing the relevant instruments should fulfil the recognition requirements set in Article 72b(2)(n) of the CRR and,

²⁸ All eligible liabilities instruments will have to include a reference to write-down and conversion when issued after 28 June 2021 (i.e. 2 years after the entry into force of that regulation).

²⁹ These refer to Article 54 CRR but could equally be applicable for Article 55 BRRD purposes.

where applicable, Article 55 of the BRRD, including the technical standards related on impracticability of contractual recognition of the bail-in clause³⁰. Therefore, from a policy and practical point of view, it is more efficient, in the interests of institutions and authorities, to recommend drafting that would meet the purpose of both provisions.

86. The AT1 standardised templates recommends standard drafting for bail-in clauses under Article 55 of the BRRD. A similar effort should be envisaged in relation to eligible liabilities, to ensure compliance with Article 55 of the BRRD as well as Article 72b(2)(n) of the CRR, taking into account their specificities. Where the provisions governing the instruments provide for an investor notification mechanism by the issuer of the exercise of the bail-in power by the resolution authority, a clause to the effect that delay or failure by the issuer to notify in advance the noteholders of the write-down or conversion action shall not affect the validity and enforceability of the bail-in or write-down and conversion powers is considered a best practice.
87. With regard to the liabilities governed by English law, on 22 March 2021, a resolution authority communicated that it will consider, for a specific time-period³¹, those liabilities without a contractual bail-in recognition clause as eligible for MREL³² if certain criteria are met.

Negative pledges

88. A negative pledge can be defined as ‘a covenant by the issuer in the terms and conditions of the issue which restricts the freedom of the issuer (and possibly other entities related to the issuer) to grant security for other debts without granting equal security for the debt in question’. The most common practice in international bond issues is that the negative pledge prohibits granting security for only other listed bonds. Such an issuer is then not able to issue secured listed bonds without granting equal security for the existing bonds but could secure different kinds of its debt, for example by taking out secured bank loans. Nevertheless, the scope of the negative pledge may vary substantially from issuer to issuer. The existence of a negative pledge, therefore, only means that the freedom of the issuer to grant security for its other debts is limited rather than unlimited.
89. Some SNP transactions allow for a negative pledge to apply to senior preferred notes, whereas senior non-preferred notes do not have the benefit of the negative pledge covenant. That such a clause is not applicable to senior non-preferred issuances seems reasonable, as it disturbs the allocation of losses and possibly impedes resolvability, which contradicts the objective of MREL. That said, some MTN programmes go further and exclude very explicitly any negative pledge, regardless of the type and ranking of the notes (i.e. for both senior preferred and senior non-preferred notes).

³⁰ [ITS on impracticability of contractual recognition of the bail-in clause](#)

³¹ The SRB stated that to ensure alignment with the prudential grandfathering of the requirement to introduce contractual recognition clauses in own funds instruments provided for in Article 494b CRR this policy will remain in place until 28 June 2025.

³² [uk_instruments_communication_march_2021.pdf \(europa.eu\)](#)

90. Although the CRR does not require an explicit clause to include a no negative pledge provision, many notes already explicitly exclude negative pledges as a standard practice, it is appropriate to recommend such exclusion as best practice.

D. Maturity

Call and put options

91. This section deals solely with discretionary options to redeem, including, make-whole clauses, clean-up calls and put options. Options on regulatory and/or tax grounds are dealt with later in this report.
92. The admissibility of call and put options for TLAC/MREL is different from that of own funds. This is linked to the fact that TLAC/MREL permanence is mainly based on residual maturity, whereas own funds must be either perpetual or compliant with minimum original maturity requirements.
93. The BRRD1 was silent on the admissibility of issuer calls and whether or not they result in shortening the residual maturity for the purpose of TLAC/MREL eligibility. It only specified the rules applicable to holder put options, providing that ‘where a liability confers upon its owner a right to early reimbursement, the maturity of that liability shall be the first date where such a right arises’³³.
94. Article 72c(2) of the CRR confirms the treatment of holder put options set out by BRRD, and Article 72c(4) of the CRR clarifies that issuer call options have no effect on the calculation of the residual maturity, provided that the instrument does not contain an incentive to redeem³⁴. If, on the contrary, the notes contain an incentive to redeem, the residual maturity is defined as the first date at which the option can be exercised³⁵.
95. The number of issuances containing issuer call options has increased in the recent past, as expected by the EBA in its first report. In general, the option is available from 1 year before maturity and usually corresponds with a fixed to floating reset mechanism at the call date, with is no subsequent call. This was obviously designed to enable a rollover, once the instrument comes below the minimum 1-year maturity required for TLAC/MREL. Redemption is usually possible in whole or in part.
96. The inclusion of make-whole provisions, that allow an issuer to redeem a bond prior to maturity on the basis of a make-whole redemption amount representing the present value of the principal amount and remaining interests, in the documentation and terms and conditions has been observed in third-country jurisdictions. In the EU, the EBA has observed that some

³³ Article 45(4) of BRRD1, last subparagraph.

³⁴ As per Article 72b(7)(b) of the CRR, the EBA is mandated to develop regulatory technical standards to specify the form and nature of incentives to redeem in the context of eligible liabilities instruments, which must be fully aligned with the technical standards on own funds.

³⁵ Article 72c(3) of the CRR.

issuers have started introducing make-whole provisions in their MTN programs, however, at this stage, none of those issuers has activated the make-whole call provision in the final terms of the own funds or eligible liabilities instruments. Furthermore, some MTN programs limit further the possible use of the make-whole provision to some categories of instruments, for example excluding them for own funds or even for Senior Non-Preferred notes in order to limit their use to Senior Preferred notes only.

97. The EBA started reviewing make-whole provisions in MTN programs and believes these clauses are complex features. In the EBA's view, the potential benefits of make-whole provisions (optionality to redeem debt between par call dates) are marginal, while the drawbacks are many. If exercised, the redemption amount could be substantially higher compared to a par call, these clauses are made to be more favourable for the holders of the instruments compared to par calls. Also, the optionality embedded into the notes makes the pricing and valuation less transparent and the analysis of incentive to redeem more complex. Furthermore, the feature could potentially reduce the flexibility for the replacement or early call of the instrument where needed (case of grandfathered instruments for example) in cases where this would lead to a too high cost for the institution. In addition, for AT1 instruments, while coupons must in principle be cancellable, the make-whole clause, if exercised, would lead to a payment of all future coupons, which might be seen as reducing the flexibility of payment/ be considered as a cumulative feature, which would not be considered compatible with the CRR eligibility criteria.
98. While make-whole clauses might not always be automatically considered as incentives to redeem, however if exercised, they would always increase the amount ultimately redeemed at the call date compared to par, make the pricing and valuation of the notes less transparent, and in some cases lead to a higher cost of the issuance. They are seen as complex features, which do not bring any additional prudential value. In this context, the EBA welcomes the prudent approach retained to date by European issuers and is of the view that these clauses should not be allowed for own funds and eligible liability instruments, issuers should use par calls instead.
99. The EBA received questions on the compliance of instruments including 'clean-up clauses', i.e. a call option that would allow the issuer to redeem the outstanding notes in the situation where a specified threshold (measured against the initial amount) of instruments is redeemed. It was questioned whether such a clause would be acceptable in AT1, Tier 2 and eligible liabilities instruments, in particular if this would be compatible with a normal call option as specified under the CRR (Articles 52(1)(i), 63(j), 72b(2)(j) CRR) and if it would raise concerns regarding incentives to redeem (Article 52(1)(g) CRR, Article 63(h) CRR and Article 72b(2)(g) CRR). In this context, the EBA clarifies that a 'clean-up clause' has to be regarded more as a way to exercise a call in a practical manner rather than as a specification of the conditions triggering a call option. In addition, 'Clean-up clauses' are considered relevant mainly in the context of repurchases before 5 years (tender offers, buybacks etc) since calls after 5 years are normally exercised for the full amount (as specified in the EBA AT1 standardised templates

clause). It is also believed that 'clean-up clauses' would be useful in cleaning the capital structure where necessary (legacy instruments for example).

100. In this context, the EBA considers that 'clean-up clauses' are acceptable for own funds and eligible liabilities under certain conditions. In particular, the 'clean-up clause' should always be linked to an action referred to in Article 77(1) of CRR which has been subject to a competent authority's prior permission, which is still valid, independent of the exact timing of the exercise of the 'clean-up clause'. In addition, it is also not relevant whether this clause can be activated within the first 5 years after the issuance of an AT1 or Tier 2 issuance or after, as long as provisions of Articles 77 and 78 CRR regarding the prior permission are fully met.
101. No holder put option provisions have been observed in the MTN programmes reviewed, which is welcome. Although some base prospectuses do not have any provisions on noteholder put options as a general rule, others do contain such provisions but put options are not applicable, as per the final terms. Among those MTN programmes that contain provisions on put options, some MTNs exclude put options for 'unsubordinated notes', whereas others restrict it to preferred senior notes; therefore, put options would never be applicable to subordinated and senior non-preferred TLAC-/MREL-eligible liabilities under those MTNs. The EBA will continue to monitor this aspect over time to ensure that put options could not be exercised at any time, and that the timing of the exercise of the put option by the holders does not lead to an infringement of the minimum maturity requirement and thus the eligibility of the instrument.
102. Finally, based on Article 78a of the CRR, which limits the capacity of institutions to redeem eligible liabilities instruments and requires the resolution authority's permission, the EBA will continue to monitor the wording of options carefully, as redemptions have the potential to hinder loss-absorbing capacity.

Incentives to redeem

103. In principle, incentives to redeem must be defined consistently across own funds and eligible liabilities, despite triggering different consequences. Both own funds and eligible liabilities are underpinned by an objective of permanence: they should offer stable funding, as otherwise loss absorption capacity would tend to disappear ahead of financial distress. This is why incentives to redeem receive a restrictive regime across both categories. It is true that, although in the case of own funds incentives to redeem are subject to a strict prohibition and trigger ineligibility, in the case of eligible liabilities they instead cause a shortening of the maturity if combined with a call option. However, this is not linked to a different concept of incentives to redeem but is because maturity conditions are more stringent for own funds, which are meant to be of a higher loss absorption quality (and thus must be perpetual or meet a longer original maturity requirement). This explains why, in mandating the EBA to develop regulatory technical standards on incentives to redeem, Article 72b(7), second subparagraph, of the CRR requires such standards to be 'fully aligned' with the own funds regulatory technical standards. This point has been effectively implemented via amendments to Article 20 of the

RTS on own funds and eligible liabilities³⁶. Similarly, guidance to be developed by the EBA (reports and Q&As) will be aligned with that developed for own funds' instruments purposes.

Supervisory approval for early redemption

104. CRR2 has expanded the supervisory permission regime in Article 77 of the CRR, previously only applicable to own funds, to cover eligible liabilities instruments as well. Article 77(2) of the CRR now requires an institution to obtain the prior permission of the resolution authority to effect the call, redemption, repayment or repurchase of eligible liabilities instruments as applicable, prior to the date of their contractual maturity. Article 78a of the CRR lays down the conditions under which the resolution authority must grant its permission. The EBA has further developed the draft regulatory technical standards³⁷ to further specify the procedure for this permission regime³⁸.
105. The MTNs systematically refer to prior permission as a condition to redemption.
106. In the area of own funds' instruments, the EBA holds the view that instruments should contain an explicit reference to regulatory conditions linked to prior permission. The EBA's Q&A ([QA 2013_544](#)) states that 'any call options, redemptions or repurchase transactions related to Tier 2 instruments must meet the requirements of Article 63(i), (j) and (k) of the CRR. For Tier 2 instruments, Article 63(j), in conjunction with Article 77 of the CRR, stipulates that the institution must not effect the call, redemption, repayment or repurchase prior to the date of an instrument's contractual maturity without the prior permission of the competent authority. Such instruments should therefore contain an explicit reference to these regulatory conditions in their terms'.
107. Indeed, in the absence of contractual provisions acknowledging prior permission regimes, an institution might be seen as contractually allowed to redeem an instrument and yet not allowed to do so as per the CRR, which could lead to difficult litigation and costly damages. For example, if an institution redeems a note whose terms and conditions do not include a clause requiring the resolution authority's prior permission, there could be disputes: the holder could seek to obtain an annulment; in the event of an annulment, the holder could engage the contractual liability of the issuer; and other investors could also seek annulments or the personal liabilities of bank managers.
108. For the same reasons, the EBA is of the view that the terms and conditions of TLAC/MREL-eligible liabilities notes should contain an explicit acknowledgement of the requirement to obtain prior permission for any call, redemption, repayment or repurchase from resolution authorities for reductions in eligible liabilities, as in the case of own funds instruments. This to ensure compliance with the CRR eligibility criteria, also in light of [Q&A 2021_6203](#). However,

³⁶ [RTS on own funds and eligible liabilities](#)

³⁷ [Draft Regulatory Technical Standards on own funds and eligible liabilities](#)

³⁸ The draft Regulatory Technical Standards on own funds and eligible liabilities will come into force once adopted by the Commission and published in the Official Journal.

this kind of provision only fully achieves its purpose if it is precisely drafted; vague terms such as ‘to the extent required’ or the ‘relevant regulator’ should be avoided now that the legislative framework has been finalised.

109. Furthermore, for secondary market purchase clauses it is recommended for MREL- eligible instruments to further align them with clauses observed in AT1 and T2 documents, and the AT1 report guidance, requiring a reference to the prior permission by the resolution authority before the purchase and to have provisions drafted in a clear manner. Furthermore, a possible enhancement to the conditions for all instruments could include a clear reference that refusal by relevant authority does not constitute an event of default.

E. Other aspects

Governing law

110. Article 59(2) of the BRRD requires Member States to confer with their resolution authorities on the powers to write down and convert relevant capital instruments and eligible liabilities. If liabilities of an institution are governed by the law of a Member State, the application of the write-down and conversion powers will therefore be effective as a matter of law.
111. In practice, however, issuances can be governed by the law of a third country. In such cases, cross-border effectiveness of the application of the bail-in tool or write-down or conversion powers is dependent on foreign courts recognising the exercise of the write-down and conversion powers of EU resolution authorities.
112. An important element of the discussion on third country law issuances is that institutions should consider the additional complexity when issuing TLAC/MREL- eligible liabilities instruments under a third country law. The EBA has observed that some competent authorities regard all TLAC/MREL- eligible liabilities issuances subject to third country law as complex and require assurance of compliance with the criteria, such as a legal opinion confirming the effectiveness and enforceability of the write-down and conversion powers of the resolution authority referred to in Article 55 of the BRRD. While this is not a legal requirement under CRR provisions, it is an option given by Article 55(3) BRRD to resolution authorities.
113. Among the observed issuances subject to a dual governing law, the notes are either governed by the laws of an EU Member State (for the insolvency ranking) and by English law³⁹ or by the law of a third country (the law of New York) as well as the law of an EU Member State.
114. In all dual governing law cases, the notes are governed by a *lex specialis* (a law applied to certain provisions of the contract) and a *lex generalis* (a law governing all other provisions). In all cases, the *lex specialis* would cover the ‘status’ of the notes, i.e. their ranking in insolvency. In some cases, the *lex specialis* would also extend to the waiver of set-off rights or to some

³⁹ Since 01.01.2021, the UK has to be considered a third country and therefore own funds instruments issued under English law have to be considered third country issuances.

specific events as defined in the terms of the notes. In other cases, the institution might be able, under the usual substitution/variation clause, to change the governing law of the condition related to the acknowledgement of national statutory loss absorption powers from a third country law to national law or visa versa.

115. In this regard, the fact that all issuances analysed consistently choose the law of the Member State of incorporation to govern the insolvency ranking of the note merely reflects the fact that, in international law, ‘the ranking of claims is always established by the *lex fori concursus*’ (law of the forum). From that perspective, a reference to a Member State’s law in relation to the ranking in insolvency of the note is insufficient to fully meet the condition set out in Article 55(1)(c) of the BRRD.

116. With regard to provisions other than ranking in insolvency, the practices are more varied.

On the one hand, Article 55 of the BRRD sets out the condition that ‘the liability is governed by the law of a third country’, without specifying which elements of the liability must be subject to third country law. Therefore, it can be argued that it is sufficient that some elements or aspects of the liability (e.g. enforceability or effects in insolvency), whatever they are, are governed by third country law in order to render Article 55 of the BRRD applicable. In this spirit, the fact that contracts refer to third country law only in relation to ‘non-contractual obligations’ or any ‘relevant clause’ is sufficient to conclude that, overall, the contract needs to contain a write-down and conversion clause.

On the other hand, the first subparagraph of Article 55(1)⁴⁰, as well as recital (26) of BRRD⁴¹, demonstrates that the article is specifically meant to ensure the enforceability of the write-down and conversion powers of resolution authorities in the EU. It could be argued on this basis that what matters for the purpose of Article 55 of the BRRD is whether a third country court or administrative authority would recognise the exercise of the write-down and conversion powers of resolution authorities in the EU⁴². Such a purpose-driven interpretation would allow for differentiating between provisions, with some aspects of the liability being governed by third country law without triggering Article 55 of the BRRD.

117. In such cases, the cross-border effectiveness of the application of the bail-in tool or write-down or conversion powers is dependent on foreign courts recognising the exercise of write-down and conversion powers of EU resolution authorities. The critical concern is whether EU resolution authorities write-down and conversion powers are effective and enforceable within the third country, i.e. do they offend the laws of that third country (all laws, not just contract

⁴⁰ ‘Member States shall require institutions and entities to include a contractual term by which the creditor or party to the agreement or instrument creating the liability recognises that liability may be subject to the write-down and conversion powers.’

⁴¹ ‘The requirement to include a contractual recognition of the effects of the bail-in tool in agreements or instruments creating liabilities governed by the laws of third countries should facilitate and improve the process for bailing in those liabilities in the event of resolution.’

⁴² By definition, as per EU law, the bail-in powers do apply to instruments issued by institutions or entities established in the EU or by branches of EU institutions established outside the Union. This statutory competence would not necessarily be accepted by a third country court or administrative authority.

law) and will the courts uphold the write-down/conversion of the securities should any holder of those securities (typically investors from the third country) challenge that write-down/conversion (either on the basis of a contractual recognition clause or otherwise), as there is no international law for the recognition of the exercise of foreign governmental powers.

118. In the case of contracts which are governed by the laws of a third country (i.e. non-EU law governed contracts), there is a risk that the effectiveness of a bail-in or resolution may be challenged under the law of the contract. For example, under a contract governed by New York law, a creditor might argue in the US courts that a conversion to equity was not agreed to under the contract or that the agreement is unenforceable or that the write-down and conversion powers otherwise offend or are unenforceable/ineffective under the laws of that third country and that the EU bank is in default of a payment obligation, notwithstanding the resolution action.
119. That said, it is notable that, with regard to new issuances, and to achieve legal certainty with regard to the loss absorbency of MREL-eligible liabilities instruments in particular, some resolution authorities⁴³ have started to supervise and offer specific guidance regarding the requirement set out in Article 55 of the BRRD that issuances governed by third country laws include contractual clauses by which holders recognise that the liability may be subject to the write-down and conversion powers of EU resolution authorities. Institutions have also been encouraged to consider issuing under the governing laws of the EU-27 Member States. In this context, the trend towards moving from dual governing laws to one single governing national law, following the United Kingdom leaving the EU, has continued in more recent issuances. The EBA will further monitor this recent development.
120. As a conclusion, it would seem prudent to apply Article 55 of the BRRD strictly, whereby institutions should include write-down and conversion clauses in all circumstances in which part or all the contract is governed by third country law to ensure TLAC/MREL eligibility.

Tax and regulatory calls

121. In its AT1 report, the EBA has laid down a number of elements of guidance regarding tax and regulatory calls. For example, the report points out that tax calls should occur only in the event of a material effect as a result of a change in tax treatment and if the change is non-foreseeable at the time of issuance.
122. Unlike the own funds' framework, the CRR/BRRD does not lay down any particular provisions with regard to tax or regulatory calls in relation to TLAC/MREL-eligible liability instruments. This is plausible because for own funds instruments those provisions are meant to derogate from a strict 5-year ban on calls, which is not applicable to TLAC/MREL-eligible liability instruments.

⁴³ [Minimum Requirement for Own Funds and Eligible Liabilities \(MREL\) – SRB Policy under the Banking Package](#), p.36.

123. Nevertheless, the existing EBA recommendation should be kept in mind when using provisions relating to tax and regulatory calls within TLAC/MREL-eligible liabilities instruments; given this, calls should not be drafted in such a way as to affect permanence without competent authorities saying so or loss absorption.
124. It can be observed that institutions have generally extended to senior non-preferred notes their usual contractual language on redemption because of a change in tax treatment. In determining the trigger for a tax call, the majority of the issuances reviewed either define a tax event as or refer to 'any change in, or amendment to, the laws and regulations of jurisdiction or any change in the official interpretation of such laws and regulations' in a very similar form. However, it usually does not include the more restrictive language that the trigger can only be a material and non-foreseeable change in the applicable tax treatment in accordance with Article 78(4) of the CRR. Going forward this would be seen as a best practice. In addition, it is observed that any redemption at the issuer's discretion due to regulatory changes is in whole, but not in part, for the outstanding notes of the respective series. This is consistent with the EBA AT1 report and constitutes another difference from discretionary calls.
125. Most MTNs reviewed specify that redemption on the ground of regulatory changes is not permitted solely on the basis that the notes are not meeting the minimum maturity anymore (e.g. it is the last year of the contract). Some specify, in addition, that a restriction on the quantum of eligible liabilities admissible for the bank (e.g. 3.5% of senior debt for G-SIIs) cannot be seen as a regulatory change. Others establish that the exclusion of all or part of a series of notes from meeting the MREL or TLAC requirements because there is insufficient headroom for such notes within a prescribed exception to the otherwise applicable general requirements for eligible liabilities does not constitute an MREL or TLAC disqualification event. This is a notable difference from discretionary calls, which, according to current observations, are precisely timed to cater for de-recognition of an instrument in the last year of maturity.
126. Issuances also generally include the equivalent of regulatory calls (usually qualified as '[TLAC/MREL] disqualification event'), i.e. changes in the framework that would result in the notes not being qualified as eligible liabilities. The wording used in MTNs to define such events is quite standard and typical for such clauses, referring to a change leading to the exclusion of the instrument from the issuer's minimum requirements. However, it usually does not include the more restrictive language of Article 78(4)(a) of the CRR (i.e. being not reasonably foreseeable at the time of their issuance as per resolutions authority's satisfaction). Going forward this would be seen as a best practice.

Tax gross-up clauses

127. The AT1 standardised templates as well as the AT1 report set up requirements for tax gross-up clauses to be deemed acceptable as part of the terms and conditions of own funds instruments. In the response provided to [Q&A 2016_2849](#), the EBA confirmed that part of the AT1 reasoning also applies to Tier 2 instruments, and that Tier 2 gross-up clauses can be

considered acceptable only if (i) they are activated by a decision of the local tax authority of the issuer, and not of the investor, and (ii) they relate to dividends and not to principal.

128. Most issuances contain tax gross-up clauses. Although some MTNs explicitly foresee the possibility of gross-up on principal and interest, others specifically restrict the gross-up to interest for senior non-preferred notes (in addition to subordinated notes) or senior preferred/senior unsecured for holding companies (Holdco's).
129. However, following the publication of the inaugural TLAC-MREL report in October 2020, the documentation usually provides that the issuer is only liable for interest and not for the principal and the clause can only be activated by a tax decision or change in law in the jurisdiction of the issuer. In some MTNs the clause has been extended to tax decision or changes in law in the jurisdiction of the group entity and not only the issuer if they are different.
130. For own funds instruments, the idea behind restricting gross-up, as set out above, is to avoid the creation of a strong redemption incentive through a gross-up event. Although the CRR does not lay down requirements or restrictions with regard to calls of TLAC/MREL issuances, it is the EBA's view that the conditions set out for own funds (AT1 and Tier 2) apply to eligible liabilities instruments as well. Consistent with the own funds framework, tax gross-up can be accepted only under certain conditions, as applicable to eligible liabilities instruments, i.e. gross-up clauses can be considered acceptable if they are activated by a decision of the local tax authority of the issuer, and if they relate to interest and not to principal.

Substitution and Variation

131. Frequently the documentation includes substitution and variation clauses, whereby the issuer may, at any time, without the consent of the holders either: (a) substitute new notes to the existing ones; or (b) vary the terms of the notes, so that the notes may become or remain compliant with the regulatory provisions applicable to the issuer and that such substitution or variation shall not result in terms that are materially less favourable to the holders. Some documentation provides for the possibility of substituting the debtor with the consent of the noteholders or with a guarantee of the original issuer, by transferring the instrument to another entity (related or not related).
132. Substitution and variation clauses should be understood as comprising only clauses which allow for the possibility for the issuer (or trustee) to modify or change contractual features (including governing law), whose purpose is to ensure that the notes comply with the regulatory eligibility criteria. Exercise of substitution and variation clauses in both own funds and eligible liabilities instruments should as a minimum be subject to receiving prior consent from the relevant authority (the reference to consent being adapted to local specificities, i.e. this might mean a prior approval under Article 77 of CRR in some jurisdictions). Where these clauses would lead to material changes that would affect the eligibility criteria of the instruments, their exercise should always be subject to the prior approval (under Article 77 of CRR) of the relevant authority. In addition, general clauses that would foresee the possibility

for holders to object to changes to the terms and conditions or to articles of association affecting their rights that could be understood in a way for holders to get additional protection in resolution are seen as non-adequate practices.

133. In those cases, in which notes might cease to be eligible as a result of one of the parties enforcing a contractual option (e.g. an option to substitute the debtor with another entity that is not related), the instrument should also contain an explicit reference to the need to obtain the prior permission of the resolution authority.

134. Furthermore, in the event that the issuer transfers the instrument from its balance sheet to that of another entity, not only prior permission according to Article 72b(2)(j) in conjunction with Article 77(2) of the CRR is required, but, if the other entity is subject to TLAC/MREL requirements and wants this instrument to qualify as an eligible liability, all the criteria for it to qualify as an eligible liability instrument in accordance with Article 72b of the CRR must also have been met at this point.



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