Helaba

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Senior unsecured bank bonds: Rising capital requirements for SNP issues

Banks will have to apply a risk weight of 150 % to senior non-preferred issues when determining their regulatory capital ratios from 1 January 2025 onwards due to amendments to the Capital Requirements Regulation (CRR). This step enshrines a clearer distinction in law between the risks of preferred and non-preferred debt instruments and completes the introduction of the two categories of senior unsecured bonds in the scope of regulatory reforms undertaken in recent years.



Dr. Susanne Knips
Senior Credit Analyst
T +49 69/91 32-32 11

More stringent regulatory capital requirements for senior non-preferred bonds effective 1 January 2025

Should a financial institution hold senior non-preferred debt issued by another financial institution, from 1 January 2025 it must apply a risk weight of 150 % to such instruments for the purposes of calculating regulatory capital ratios. This arises from amendments to the Capital Requirements Regulation that will be applicable from 2025 (Article 128 CRR III-E in conjunction with Article 72b CRR).

Amendments to Capital Requirements Regulation CRR III-E

The context of these changes can be found in Regulation 2024/1623 passed by the European Parliament and the European Council on 31 May 2024[1] which made sweeping amendments to the Capital Requirements Regulation 575/2013, or CRR. In the following, we discuss the treatment of senior unsecured bank bonds when determining the regulatory capital ratios of a financial institution that holds such instruments.[2]

For this purpose, the revised Article 128 CRR III-E contains a significant change relating to subordinated debt exposures, which are initially defined in paragraph 1. Pursuant to paragraph 1 point (c), they also include eligible liabilities in accordance with Article 72b CRR, i.e. liabilities that can be used to meet a bank's total loss absorbing capital TLAC/MREL requirements. In future, such subordinated debt instruments will be assigned a risk weight of 150 % (Article 128 (2) CRR III-E).

Up to now, Article 128 CRR has regulated items associated with a particularly high risk, including equity investments, among others. The latter has already been subject to a risk weight of 150 %. In contrast, no distinction has been made in respect of senior unsecured bank bonds. To date, the risk weight of senior non-preferred debt (SNP bonds), in common with senior preferred (SP bonds), has been based on the respective rating (Article 120 CRR) or, if no rating is available, on the country rating in which the issuer is incorporated (Article 121 CRR). In this case, the risk weight ranges between 20 % and 150 %.

[1] published in Official Journal of the European Union on 19 June 2024
[2] for more on changes introduced by Basel IV, see our publication "Major European banks: Well prepared for Basel IV" of 18 June 2024

In future, SNP bonds will be regulated under Article 128 CRR III-E and will consequently be assigned a risk weight of 150 % when determining an institution's regulatory minimum capital requirement as these instruments qualify as eligible liabilities pursuant to Article 72b (2) CRR.

Uncertainty with regards to TLAC eligibility of preferred bonds

Currently, it is unclear whether some SP bonds will also be affected by the higher risk weight requirement as Article 128 CRR III-E refers to all instruments covered by Article 72b CRR. Paragraph 3 of the latter provides for global systemically important banks or banking groups (G-SIBs) to include SP bonds up to an amount that does not exceed 3.5 % of an institution's total risk exposure when calculating its TLAC requirement. Accordingly, the competent resolution authority may permit liabilities up to this amount and under certain conditions to be recognised as eligible liabilities instruments.

In our view, however, there are fundamentally good reasons not to assign the same risk weight as SNP bonds of 150 % to SP bonds as well. Based on our interpretation of the new regulations, the goal is to ensure that reforms carried out in recent years are also reflected in the regulatory risk weights and, as such, to make a distinction between the different risk classes. The fact that SP bonds rank senior to SNP bonds in the insolvency ranking will not make any difference in practice if the latter bonds are permitted by a resolution authority to count as part of a G-SIB's TLAC ratio.

We believe it would be more expedient if Article 128 CRR III-E referred solely to Article 72b paragraph 2, rather than additionally paragraphs 3 and 4 which permit PS bonds to count towards a G-SIB's TLAC ratio - albeit in exceptional cases and to a limited extent. This would make it clear that only bank bonds ranking non-preferred would be subject to a risk weight of 150 %.

Nevertheless, ambiguity regarding the treatment of certain SP bonds is unlikely to have any significant practical relevance in our view. As we understand the regulations, the vast majority of PSP bonds issued by non-G-SIBs, or by G-SIBs but not eligible to count towards their TLAC requirement, will remain subject to Article 120 CRR III-E. Indeed, the draft CRR III-E regulation even provides for a reduction in the risk weight for exposures to institutions at credit quality step 2 for which a credit assessment by a nominated ECAI is available from the current level of 50 % to 30 % from 1 January 2025 (with a residual maturity of more than 3 months).

New CRR III-E only introduces minor changes to treatment of SP bonds

Exposures pursuant to Article 120 CRR to institutions for which a credit assessment by a nominated ECAI is available

Credit quality step	1	2	3	4	5	6
New CRR III-E risk weight	20%	30%	50%	100%	100%	150%
Previous risk weight	20%	50%	50%	100%	100%	150%

Sources: Official Journal of the European Union, Helaba Research & Advisory

Clarification by EBA pending

Clarification by the European Banking Authority (EBA), which is responsible for drawing up regulatory technical standards and interpretations (Q&A), of uncertainty regarding the treatment of SP bonds is eagerly awaited. However, time is running out as the new CRR III-E will apply from 1 January 2025. That said, most European G-SIBs do not utilise the limited options available of including SP bonds towards their TLAC ratios as these institutions' regulatory capital ratios are high even without these instruments.

In this connection, it is interesting to note the response of Société Générale, which is classed as a G-SIB. When reporting its quarterly earnings for Q2 2024, it announced that it had decided to no longer exercise the option under Article 72b (3) CRR of using senior preferred debt to meet its TLAC requirement. This is consistent with our expectation that, under a strict interpretation of the current CRR III-E regulation, G-SIBs will no longer include PS Bonds in their TLAC ratios.

The bottom line is that investors must pay close attention to the structure of the bonds they hold. In accordance with Article 437a CRR, issuing banks must disclose which instruments they use to meet their regulatory capital ratios.

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Publisher and editor

Helaba Research & Advisory

Editor:
Stefan Rausch
Corporate Research & Advisory

Publisher:
Dr. Gertrud R. Traud
Chief Economist/
Head of Research & Advisory

Neue Mainzer Str. 52-58
60311 Frankfurt am Main
Germany
T +49 69 / 91 32 - 20

Internet: www.helaba.com

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