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EUROPEAN CENTRAL BANK

OPINION OF THE EUROPEAN CENTRAL BANK

of 8 March 2017

on a proposal for a directive of the European Parliament and of the Council on amending Directive 2014/59/EU as regards the ranking of unsecured debt instruments in insolvency hierarchy

(CON/2017/6)

(2017/C 132/01)

Introduction and legal basis

On 3 January 2017 and 17 February 2017, respectively, the European Central Bank (ECB) received requests from the Council of the European Union and the European Parliament for an opinion on a proposal for a directive of the European Parliament and of the Council on amending Directive 2014/59/EU of the European Parliament and of the Council as regards the ranking of unsecured debt instruments in insolvency hierarchy [1] (hereinafter the 'proposed directive').

The ECB's competence to deliver an opinion is based on Articles 127(4) and 282(5) of the Treaty on the Functioning of the European Union since the proposed directive contains provisions affecting the basic task of the European System of Central Banks (ESCB) of implementing the monetary policy of the Union pursuant to the first indent of Article 127(2) of the Treaty, the ESCB's contribution to the smooth conduct of policies relating to the stability of the financial system, as referred to in Article 127(5) of the Treaty, and the tasks conferred upon the ECB pursuant to Article 127(6) of the Treaty concerning policies relating to the prudential supervision of credit institutions. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

1. General observations

1.1. The ECB welcomes the proposed directive, which sets out amendments to Directive 2014/59/EU of the European Parliament and of the Council [2] relating to the insolvency ranking of holders of debt instruments issued by Union credit institutions, and certain other institutions, as part of a broader set of legislative proposals for amending the Union's financial services regulatory framework [3]. The amendments to Article 108 of Directive 2014/59/EU aim to enhance the implementation of the bail-in tool provided for under Directive 2014/59/EU and to facilitate the application of the minimum requirement for own funds and eligible liabilities (MREL) and the forthcoming total loss-absorbing capacity (TLAC) requirement [4] concerning the loss-absorption and recapitalisation capacity of credit institutions and investment firms. As such, the amendments provide an additional means for credit institutions and certain other institutions to comply with the forthcoming TLAC and MREL requirements and improve their resolvability, without constraining their respective funding strategies. This reform should be adopted as soon as possible to assist credit institutions in their preparations for meeting the new requirements, especially where such institutions are faced with a shortfall in building up the necessary levels of loss-absorbing liabilities (where subordination is required), and in light of potential constraints on the capacity of markets to rapidly absorb large volumes of new issuances.

[1] COM(2016) 853 final.

[2] Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council (OJ L 173, 12.6.2014, p. 190).

[3] The ECB has been consulted by the Council on the broader set of legislative proposals put forward by the Commission, and the ECB's opinion on those proposals may contain further observations relevant to the subject-matter of this opinion, in particular as regards the proposals for 'eligible liabilities instruments'.

[4] See the Financial Stability Board's (FSB's) 'Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution: Total Loss-absorbing Capacity (TLAC) Term Sheet', 9 November 2015, available on the FSB's website at www.fsb.org.

1.2. The ECB fully shares the Commission's view that harmonised rules in the internal market on the treatment of certain bank creditors in insolvency and resolution are needed in order to reduce divergences between national rules concerning the loss absorbency and recapitalisation capacity of banks, which could distort competition in the internal market. The ECB notes that harmonisation in this area is particularly important to safeguard financial stability as well as to foster effective and efficient resolution action, including the implementation of the bail-in tool under Directive 2014/59/EU in a cross-border context, and to reduce uncertainty for issuers and investors.

1.3. The ECB reiterates its position [1] that a common framework at Union level on the hierarchy of creditors, including as regards subordination of debt instruments and other similar financial instruments in bank resolution and/or insolvency proceedings, may help to advance the integration of the financial services markets within the Union and facilitate the tasks of the ECB with regard both to monetary policy and supervision within the Single Supervisory Mechanism.

1.4. The ECB considers that the proposed directive only provides for partial harmonisation and that additional reforms would be useful to promote further harmonisation in the hierarchy of creditor claims in bank insolvency. In particular, a general depositor preference rule, based on a tiered approach, should be enshrined in Union legislation. This would enhance resolvability by clarifying the hierarchy of creditors and facilitating the allocation of losses to unsecured bank debt instruments ahead of certain operational liabilities, while alleviating concerns regarding the 'no creditor worse off than under normal insolvency proceedings' principle [2].

2. Specific observations

2.1. *New asset class of 'non-preferred' senior debt instruments*

The ECB welcomes the proposal in the proposed directive for the creation of a new asset class of 'non-preferred' senior debt instruments with a lower rank than ordinary senior unsecured debt instruments in insolvency. This lower rank is established by a statutory framework that recognises the contractual subordination arrangements contained in the relevant contractual terms and conditions for the issuance of such 'non-preferred' senior debt instruments.

2.1.1. Regarding the requirement that the new asset class of 'non-preferred' senior debt instruments must have an initial maturity of one year, the ECB is of the opinion that credit institutions [3] and certain other institutions should be allowed to issue 'non-preferred' senior debt instruments with initial maturities that are either more than or less than one year. While 'non-preferred' senior debt instruments with an initial or residual maturity of less than one year would not be eligible as regards meeting MREL or TLAC requirements, such instruments could still be bailed-in, thus increasing the institution's loss-absorption capacity. The ECB notes that where 'non-preferred' senior debt instruments are issued with initial maturities of more than one year, this would positively extend the average maturity of this asset class, thereby contributing to improving the resolvability of institutions.

2.1.2. Regarding the requirement that the new asset class of 'non-preferred' senior debt instruments must have no derivative features, it might be worthwhile considering if further reflection would be useful as to whether the question of what constitutes a derivative feature could be usefully clarified for this purpose at this stage, possibly through the development of regulatory technical standards.

2.1.3. The ECB understands that the proposed framework for the statutory recognition of contractual subordination pursuant to the terms and conditions of 'non-preferred' senior debt instruments as a new asset class would not preclude Member States from maintaining a statutory subordination regime [4]. The proposed directive envisages that 'non-preferred' senior debt instruments will have a lower rank than 'ordinary unsecured claims resulting from debt instruments with the highest priority ranking among debt instruments in national law governing normal insolvency proceedings'. However, this approach may not be easily accommodated in Member States where the subordination of senior unsecured debt instruments has already been established on a statutory basis in

[1] See, for example, Opinions CON/2016/28, CON/2016/7, and CON/2015/31. All ECB opinions are available on the ECB's website at www.ecb.europa.eu.
[2] See paragraph 3.1.2 of Opinion CON/2016/28 and paragraph 3.7.1 of Opinion CON/2015/35.
[3] Note that 'non-preferred' senior debt instruments could also be issued by a subsidiary in the form of internal MREL for the purposes of a single point of entry strategy, and such instruments should also be available for loss-absorption in a pre-resolution phase, where the subsidiary as the issuing institution is not placed under resolution.
[4] For discussion of national insolvency frameworks providing for statutory subordination of senior unsecured debt instruments, please see Opinions CON/2016/28 and CON/2015/31.

national law [1], and where such instruments are currently allocated the lowest rank among senior liabilities. For these jurisdictions, the proposed directive could usefully clarify that 'non-preferred' senior debt instruments rank *pari passu* with senior unsecured debt instruments already subject to statutory subordination. Further differentiation in the hierarchy of creditor claims with 'non-preferred' senior debt instruments ranking at a different (lower) rank may not be necessary. In Member States where statutory subordination has already been implemented, credit institutions would be in a position to use the existing stock of senior debt instruments for loss absorption, without the immediate need to issue new 'non-preferred' senior debt instruments. In order to foster harmonisation as regards the manner in which subordination of senior unsecured debt instruments is achieved in the hierarchy of creditor claims, and to promote the creation of a single market for such debt instruments, it would be useful for the proposed directive to include a provision specifying that whenever existing debt instruments that are subject to statutory subordination reach maturity, new issuances of senior debt instruments that are intended to be subordinated should be aligned, where appropriate (e.g. no derivative features), with the regime established for 'non-preferred' senior debt instruments.

2.1.4. It should be clarified that, for the purposes of the subordination requirements laid down in Regulation (EU) No 575/2013 of the European Parliament and of the Council [2] and Directive 2014/59/EU, senior debt instruments subject to statutory subordination or structural subordination will remain eligible, subject to the applicable criteria for 'eligible liabilities instruments', in addition to the new asset class of 'non-preferred' senior debt instruments.

2.2. *Transitional arrangements*

The ECB draws attention to the need for clarity regarding the envisaged transitional arrangements applicable to senior unsecured debt instruments that are outstanding at the point in time when the new regime takes effect, including any grandfathering regime required (see paragraph 2.1.3). Such clarity is essential to ensuring legal certainty for investors and issuers during the transitional period. The ECB understands that existing national laws will continue to apply to debt instruments that were already outstanding prior to the date of application of the proposed directive. Moreover, the ECB considers that uncertainty may arise with respect to the applicable legal regime for new issuances in the interim period between the proposed directive's date of application and the date when the new regime is implemented in national insolvency law. In particular, the cut-off date for the application of national laws as envisaged in the proposed directive should be reconsidered as it is set well before the envisaged application date of the proposed directive. Due consideration should be given to the fact that it may take additional time for changes in national insolvency law to take effect following the implementation of the proposed directive.

2.3. *General depositor preference*

2.3.1. The ECB sees merit in the introduction of a general depositor preference, based on a tiered approach, in the Union [3]. This would be complementary to the proposals set out in the proposed directive. Typically, under a general depositor preference rule all depositor claims rank higher than the claims of ordinary unsecured non-preferred creditors, whereas in a tiered depositor preference regime insured (or guaranteed) deposits rank higher than eligible deposits, but uninsured deposits still rank higher than other senior liabilities [4]. It is worth noting that Member States are not precluded under Directive 2014/59/EU from establishing general depositor preference rules in national law [5], and recently a number of Member States have done so [6].

(1) In this context statutory subordination means the subordination, based on a statutory framework applicable to the issuer, of an unsecured debt instrument that is not also subject to subordination pursuant to the terms and conditions of the debt instrument, i.e. contractual subordination.

(2) Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1).

(3) See paragraph 3.1.2 of Opinion CON/2016/28 and paragraph 3.7.1 of Opinion CON/2015/35. See also Transcript of the questions and answers following the ECB President's Introductory statement to the ECB's press conference of 4 April 2013, available on the ECB's website at www.ecb.europa.eu.

(4) See the International Association of Deposit Insurers' 'Core Principles for Effective Deposit Insurance Systems', November 2014, p. 8. For example, a general (national) depositor preference has been embedded in US legislation since 1993, where in the liquidation of a failed insured depository institution a preference is granted by law to any domestic deposit liability of the institution ahead of any other general or senior liability of the institution. See sections 1821(d)(11)(A) and 1813(l)(5)(A) of Title 12, Chapter 16 of the U.S. Code.

(5) See paragraph 3.1.3 of Opinion CON/2016/28.

(6) See Article 91 of the Italian Banking Law (Legislative Decree no. 385 of 1 September 1993); Article 207 of the Slovenian Law on the resolution and winding-up of banks (OJ 44/2016); and Article 145A of the Greek banking law (Law 4261/2014).

2.3.2. The ECB notes that conferring a priority ranking on all deposits is expected to enhance the implementation of the bail-in tool in resolution, because the resolution authority will be able to bail in other senior unsecured bank debt instruments prior to deposits, while minimising the risk of compensation claims under the 'no creditor worse off' principle. The bail-in of such senior unsecured bank debt instruments is regarded as carrying a lower contagion risk than that of operational liabilities such as deposits. A general depositor preference is therefore likely to render the bail-in of senior unsecured bank debt instruments more effective and credible, thus fostering effective resolution action and reducing the need to have recourse to the resolution fund [1].

2.3.3. In addition to enhancing resolvability, establishing a general depositor preference, based on a tiered approach, across the Union would promote further harmonisation in the Union as regards the hierarchy of creditor claims in bank insolvency [2].

2.3.4. The current regime under Directive 2014/59/EU requires Member States to ensure that in national laws governing normal insolvency proceedings a higher priority ranking among unsecured claims is given to deposits up to the EUR 100 000 coverage level ('covered deposits'), which are guaranteed by the deposit guarantee scheme (DGS) [3]. A second priority ranking is granted to eligible deposits exceeding the EUR 100 000 coverage level held by natural persons or micro, small or medium-sized enterprises [4]. Large corporate deposits rank below, typically *pari passu* with other claims of ordinary unsecured creditors of the credit institution in accordance with national laws. The ECB understands that the ranking of other preferential claims, such as tax and employee wage claims, is determined by the applicable national laws. A general depositor preference, based on a tiered approach, could be achieved by introducing a third priority ranking in Article 108 of Directive 2014/59/EU for other deposits, such as large corporate deposits, deposits by credit institutions, collective investment undertakings, pension funds etc., which would rank below the higher priority ranking for covered deposits and the preference for certain eligible deposits, but ahead of other senior liabilities [5].

2.4. *Treatment of Tier 2 instruments*

Despite the improvement sought by the proposed directive, the ongoing fragmentation between national insolvency regimes may continue to pose challenges. This is particularly the case in respect of the treatment of Tier 2 instruments and other subordinated liabilities in insolvency and resolution. Whereas some national insolvency regimes differentiate between the rank of Tier 2 instruments and that of other subordinated liabilities in insolvency, in other jurisdictions Tier 2 instruments rank *pari passu* with other types of subordinated liabilities. This may complicate the exercise of bail-in powers, such as write-down and conversion, by the resolution authorities under Directive 2014/59/EU, since Tier 2 instruments are to be bailed-in prior to subordinated debt where the latter does not constitute Additional Tier 1 or Tier 2 capital [6]. Further harmonisation should be sought in this area, for example by requiring that national insolvency regimes should be aligned in such a way that Tier 2 instruments are treated differently and rank below other subordinated liabilities. Another area for further consideration is the ranking of intra-group liabilities in the hierarchy of creditor claims in bank insolvency.

2.5. *Effect on the eligibility of debt instruments as collateral for Eurosystem credit operations*

The ECB notes the potential implications of subordinating senior debt instruments to other debt instruments of the same issuer with respect to the eligibility of the former as collateral for Eurosystem credit operations.

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(1) See paragraph 3.1.2 of Opinion CON/2016/28 and paragraph 3.7.1 of Opinion CON/2015/35.
(2) See paragraph 3.7.3 of Opinion CON/2015/35.
(3) Note that the DGS enjoys the same priority ranking where it is subrogated to the rights and obligations of depositors following reimbursement of covered deposits.
(4) The same ranking is also granted to deposits which would be eligible for coverage under the DGS had they not been made through branches of Union credit institutions located in a jurisdiction which is not a Union or European Economic Area Member State.
(5) Certain smaller credit institutions may predominantly rely on large deposits (i.e. deposits above EUR 100 000 other than from natural persons, micro, small or medium-sized enterprises) with a remaining maturity of at least one year to meet their MREL requirement, provided no subordination requirement is imposed by the resolution authority. The ECB notes that the Commission proposes to amend Article 45(4)(f) of Directive 2014/59/EU and to introduce a new Article 45b into Directive 2014/59/EU (which refers to the new Articles 72a and 72b of Regulation (EU) No 575/2013), and these proposed amendments are understood not to preclude reliance on large corporate deposits with a remaining maturity of at least one year for the purpose of meeting the MREL requirement in the same manner as under the current regime.
(6) See Article 48(1) of Directive 2014/59/EU.

Guideline (EU) 2015/510 of the European Central Bank (ECB/2014/60) [1] sets out a single framework that applies in the Eurosystem to assets that may be submitted as eligible collateral for such operations. In order to be eligible as collateral, marketable assets must be debt instruments fulfilling the eligibility criteria laid down in Guideline (EU) 2015/510 (ECB/2014/60). Pursuant to Article 64 of the Guideline, 'eligible debt instruments shall not give rise to rights to the principal and/or the interest that are subordinated to the rights of holders of other debt instruments of the same issuer' [2].

2.6. *Technical observations and drafting proposals*

Where the ECB recommends that the proposed directive should be amended, specific drafting proposals are set out in a separate technical working document accompanied by an explanatory text to this effect. The technical working document is available in English on the ECB's website.

Done at Frankfurt am Main, 8 March 2017.

The President of the ECB

Mario DRAGHI

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(1) Guideline (EU) 2015/510 of the European Central Bank of 19 December 2014 on the implementation of the Eurosystem monetary policy framework (ECB/2014/60) (OJ L 91, 2.4.2015, p. 3).

(2) See, in particular, paragraph 3.3 of Opinion CON/2016/7.

IV

(Notices)

NOTICES FROM EUROPEAN UNION INSTITUTIONS, BODIES, OFFICES AND AGENCIES

EUROPEAN COMMISSION

Euro exchange rates (1)

25 April 2017

(2017/C 132/02)

1 euro =

	Currency	Exchange rate		Currency	Exchange rate
USD	US dollar	1,0891	CAD	Canadian dollar	1,4790
JPY	Japanese yen	120,34	HKD	Hong Kong dollar	8,4756
DKK	Danish krone	7,4396	NZD	New Zealand dollar	1,5636
GBP	Pound sterling	0,84928	SGD	Singapore dollar	1,5170
SEK	Swedish krona	9,6010	KRW	South Korean won	1 228,28
CHF	Swiss franc	1,0826	ZAR	South African rand	14,2071
ISK	Iceland króna		CNY	Chinese yuan renminbi	7,4976
NOK	Norwegian krone	9,3158	HRK	Croatian kuna	7,4645
BGN	Bulgarian lev	1,9558	IDR	Indonesian rupiah	14 460,53
CZK	Czech koruna	26,771	MYR	Malaysian ringgit	4,7550
HUF	Hungarian forint	311,70	PHP	Philippine peso	54,078
PLN	Polish zloty	4,2273	RUB	Russian rouble	61,0111
RON	Romanian leu	4,5255	THB	Thai baht	37,487
TRY	Turkish lira	3,9127	BRL	Brazilian real	3,4329
AUD	Australian dollar	1,4454	MXN	Mexican peso	20,5205
			INR	Indian rupee	70,0130

(1) *Source*: reference exchange rate published by the ECB.

COURT OF AUDITORS

Special Report No 6/2017

'EU response to the refugee crisis: the "hotspot" approach'

(2017/C 132/03)

The European Court of Auditors hereby informs you that Special Report No 6/2017 'EU response to the refugee crisis: the "hotspot" approach' has just been published.

The report can be accessed for consultation or downloading on the European Court of Auditors' website: http://eca.europa.eu

V

(Announcements)

ADMINISTRATIVE PROCEDURES

EUROPEAN COMMISSION

Call for proposals under the multiannual work programme for granting financial aid in the field of the trans-European energy infrastructure under the Connecting Europe Facility for period 2014-2020

(Commission Decision (C(2017) 2109))

(2017/C 132/04)

The European Commission, Directorate-General for Energy, is hereby launching a call for proposals in order to award grants in accordance with the priorities and objectives defined in the multiannual work programme in the field of the trans-European energy infrastructure under the Connecting Europe Facility for the period 2014-2020.

Proposals are invited for the following call:

CEF-Energy-2017

The indicative amount available for the selected proposals under this call for proposals is EUR 800 million.

The deadline for the submission of proposals is **12 October 2017**.

The complete text of the call for proposals is available on the call webpage:

https://ec.europa.eu/inea/en/connecting-europe-facility/cef-energy/calls/2017-cef-energy-call-proposals

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