OPINION OF THE EUROPEAN CENTRAL BANK
of 23 February 2016
on the hierarchy of creditors of credit institutions
(CON/2016/7)

Introduction and legal basis

On 21 January 2016 the European Central Bank (ECB) received a request from the French Ministry of Finance and Public Accounts for an opinion on draft provisions on the hierarchy of creditors of credit institutions (hereinafter the 'draft provisions')[1].

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 and the sixth indent of Article 2(1) of Council Decision 98/415/EC[2], as the draft provisions relate to rules applicable to financial institutions insofar as they materially influence the stability of financial institutions and markets. 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. Purpose of the draft provisions

1.1 The purpose of the draft provisions is to introduce a new category in the ranking of creditors of credit institutions under French insolvency law, in order to facilitate the implementation of resolution procedures, as provided for in Directive 2014/59/EU of the European Parliament and of the Council[3], by creating legal certainty about the loss absorbing capacity of a newly created class of senior unsecured debt securities or instruments (hereinafter referred to as 'senior non-preferred debt instruments').

1.2 More precisely, the draft provisions amend Article L. 613-30-3 of the French Monetary and Financial Code, which are applicable if a liquidation proceeding is brought against a credit institution. In particular, the draft provisions introduce in the existing insolvency hierarchy of creditors of a credit institution the new category of senior non-preferred debt instruments. These senior non-preferred debt instruments consist of debt securities or instruments with characteristics similar to debt securities other than structured debt securities. A decree by the State Council (Conseil d'Etat) will specify the conditions under which an instrument is considered not to be

1 The draft provisions will be inserted in the draft law on the prevention of corruption and the promotion of the transparency of the economy.

2 Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions (OJ L 189, 3.7.1998, p. 42).

3 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).

structured. The original maturity date of senior non-preferred debt instruments will be not less than one year but the decree to be issued may provide for a minimum maturity date of longer than a year. Finally, the contract of issuance for senior non-preferred debt instruments is required to provide that the owner or holder is unsecured within the meaning of this specific provision creating this new category of senior non-preferred debt instruments.

1.3 In the hierarchy of creditors, owners of senior non-preferred debt instruments will rank before creditors holding subordinated debt and after the following categories of creditors, respectively: (1) certain specified preferential or secured creditors; (2) creditors in respect of the portion of their deposits covered by the Deposit Guarantee Scheme (DGS); (3) certain other specified depositors, comprising natural persons and micro, small and medium-sized enterprises either (a) for the portion of their deposits that are eligible for coverage under the DGS and which exceed the coverage level of EUR 100,000 or (b) for the deposits which would be eligible for coverage under the DGS if they had not been made with branches of a credit institution located in a country which is not a Member State of the European Union or the European Economic Area; and (4) creditors other than owners of senior non-preferred debt instruments (hereinafter referred to as 'senior preferred debt'). The draft provisions also specify that the new provisions do not have retroactive effect and will apply only to insolvency proceedings that commenced following the entry into force of the law that will contain the draft provisions.

2. General observations

2.1 The ECB welcomes that the draft law aims to increase the resolvability of banks, by creating legal certainty about the loss-absorbing capacity of the newly created class of senior non-preferred debt instruments.

2.2 The ECB notes that the creation of a new category of senior non-preferred debt instruments in the insolvency ranking of unsecured claims against French credit institutions, subordinated to senior preferred debt, is proposed to be achieved by establishing a statutory basis for the issuance of debt instruments, which include contractual subordination arrangements.

2.3 A common framework at Union level on the degree of subordination of senior unsecured bank debt instruments to other senior unsecured bank liabilities in bank resolution and/or insolvency proceedings, would avoid the fragmentation of the market within the Union for these instruments and also avoid complicating the tasks of the ECB with regard to supervision within the Single Supervisory Mechanism (SSM).

3. Specific observations

3.1 *Effects on loss-absorbing capacity in resolution and TLAC requirement*

Changing the statutory creditor hierarchy in bank insolvency proceedings is expected to enhance the loss-absorbing capacity of banks in resolution, to the extent that they issue debt instruments belonging to this new category of senior non-preferred debt instruments. By means of the subordination of any new senior non-preferred debt instruments issued, which would be achieved contractually, the resolution authority may allocate losses in resolution to these senior non-preferred debt instruments prior to senior preferred debt, which would include operational liabilities such as corporate deposits and derivatives. The clear distinction in the insolvency ranking that results from the establishment of a statutory basis for the issuance of debt instruments, which include contractual subordination arrangements, will increase legal certainty regarding the ability of senior non-preferred debt instruments to absorb losses and, hence, help to minimise the risk of compensation claims under the 'no-creditor-worse-off-than-in-insolvency' principle. Imposing losses on such senior non-preferred debt instruments is regarded as carrying a lower contagion risk than that of operational liabilities included within senior preferred debt, which is why the loss absorbency of senior non-preferred debt instruments is likely to be more effective and credible to market participants. To the extent that French credit institutions will issue senior non-preferred debt instruments, it will be possible to allocate losses in resolution to the holders of such instruments, who would bear losses ahead of senior preferred debt. Depending on how substantial the layer of new senior non-preferred debt instruments will be in a given bank, this has the potential to foster effective resolution action and reduce the need to have recourse to the resolution fund, which is expected to promote adequate pricing of risk for investors. The facilitation of such contractual subordination is therefore expected to improve the resolvability of credit institutions under the Union resolution regime and enhance market discipline.

3.2 In addition, the establishment of a statutory basis for the issuance of debt instruments, which include contractual subordination arrangements, may, to some extent, facilitate the implementation of the FSB's standard for a minimum Total Loss-Absorbing Capacity (TLAC) requirement for globally systemically important banks (G-SIBs) which, in particular, requires TLAC-eligible debt instruments to be contractually, statutorily or structurally subordinated to operational liabilities[4]. The creation of a statutory basis for the issuance of senior non-preferred debt instruments gives French G-SIBs an additional option to meet their TLAC requirement through the issuance of new debt instruments belonging to the category of senior non-preferred debt. However, the draft provisions will not change the ranking of debt instruments that have already been issued and it still requires all newly issued debt instruments to contain an explicit contractual clause in order to be subordinated. Thus, French banks will still be required to issue new debt instruments in order to meet the required amount of TLAC-eligible debt instruments within the remaining timeframe.

3.3 *Effects on eligibility of debt* instruments *as collateral for Eurosystem credit operations*

Guideline (EU) 2015/510 of the European Central Bank (ECB/2014/60)[5] sets out a single framework that applies in the Eurosystem for assets that can be submitted as eligible collateral for the purpose of participating in Eurosystem monetary operations. In order to be eligible as collateral for such operations, marketable assets must be debt instruments fulfilling the eligibility criteria laid down in Guideline (EU) 2015/510 (ECB/2014/60). In accordance with Article 64 of Guideline (EU) 2015/510 (ECB/2014/60), eligible debt instruments will not give rise to rights to the principal

4 Minimum TLAC must be at least 16 % of the resolution group's Risk Weighted Assets ("TLAC RWA Minimum") as from 1 January 2019 and at least 18 % as from 1 January 2022. Minimum TLAC must also be at least 6 % of the Basel III leverage ratio denominator ("TLAC linear rational expectation minimum") as from 1 January 2019 and at least 6.75 % as from 1 January 2022.

5 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).

and/or the interest that are subordinated to the rights of holders of other debt instruments of the same issuer. Due to the subordination of senior non-preferred debt instruments to senior preferred debt, senior non-preferred debt instruments would not be eligible as collateral for Eurosystem credit operations.

This opinion will be published on the ECB's website.

Done at Frankfurt am Main, 23 February 2016.

[signed]

The President of the ECB

Mario DRAGHI