



## OPINION OF THE EUROPEAN CENTRAL BANK

of 8 June 2017

**on a new category of debt instruments, new macroprudential tool, the creation of a new category of settlement institution and the exclusion of set-off rights**

**(CON/2017/23)**

### **Introduction and legal basis**

On 3 April 2017, the European Central Bank (ECB) received a request from the Governor of the Nationale Bank van België/Banque Nationale de Belgique (NBB), on behalf of the Minister of Finance, for an opinion on a draft law on various financial and tax provisions (hereinafter the 'draft law').

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 (TFEU) and the third, fourth, fifth and sixth indents of Article 2(1) of Council Decision 98/415/EC<sup>1</sup>, since the draft law concerns the NBB, the collection of balance of payments statistics, payment and settlement systems as well as 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 law**

- 1.1 The draft law amends various provisions contained in (a) the Law of 22 February 1998 establishing the Organic Statute of the Nationale Bank van België/Banque Nationale de Belgique (hereinafter the 'NBB Organic Law'); (b) the Royal Decrees of 14 November 2008 and 22 April 2012 implementing the NBB Organic Law as regards the establishment of the guarantee fund for financial services; (c) the Law of 28 February 2002 organising the establishment of the balance of payments (hereinafter the 'Law of 28 February 2002'); and (d) the Law of 25 April 2014 on the status and supervision of credit institutions and brokerage firms (hereinafter the 'Banking Law').
- 1.2 The draft law amends the NBB Organic Law in order to specify that the set-off that might result in the extinguishment of all or part of the claims pledged to the NBB or enforced by the NBB may not be asserted against the NBB or any other third-party purchasers of the said claims. According to the explanatory memorandum accompanying the draft law<sup>2</sup>, under the current text of Article 7 of the NBB Organic Law a third party purchasing such a credit claim does not benefit from the exclusion of set-off rights. This implies that the debtor of pledged claims is able to assert a right of

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<sup>1</sup> Council Decision 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).

<sup>2</sup> See section entitled 'Comments on the articles' in the explanatory memorandum, pp. 10-12.

set-off against a third-party purchaser of the claims in the same way that it can assert a right of set-off against its creditor. This situation lowers the sale value of the credit claims involved and could expose the NBB to potential losses, as it may incur liability towards the third-party purchaser. To neutralise this risk, the draft law proposes to expand the scope of the exclusion of set-off rights, which would therefore also benefit a third-party purchaser of the credit claim, in line with recent legislative amendments passed in France and Italy. However, the draft law does not extend the protection provided by this provision to the ECB and to other national central banks (NCBs) of the European System of Central Banks (ESCB)<sup>3</sup>.

- 1.3 The draft law also amends the NBB Organic Law to clarify that the NBB's decisions relating to its task of contributing to the stability of the financial system may not be suspended or opposed by the Minister of Finance.
- 1.4 The draft law establishes a new category of institutions which may, in addition to the provision of custody, account maintenance and financial instrument settlement services, also carry out settlement-related non-banking services as well as certain specified activities. According to the explanatory memorandum<sup>4</sup>, the low risk profile of these credit institutions, whose business model consists mainly of holding financial instruments on their customers' behalf, calls for a prudential supervisory approach specific to their risk profile. These credit institutions will accordingly be treated similarly to settlement institutions as far as prudential supervisory rules are concerned, without becoming fully fledged settlement institutions governed by Regulation (EU) No 909/2014 of the European Parliament and of the Council<sup>5</sup>.
- 1.5 The draft law also empowers the NBB, when acting in its capacity as macroprudential supervisor, to impose on credit institutions and brokerage firms minimum funding requirements consisting of (a) Common Equity Tier 1 or additional Tier 1 or Tier 2 capital; (b) subordinated debt; (c) the debt instruments belonging to the new category of senior non-preferred debt (see paragraph 1.8 below); and (d) any liabilities that may be subject to bail-in. According to the explanatory memorandum<sup>6</sup>, this provision aims at strengthening the arsenal of macroprudential tools available to the NBB, which will be empowered to impose additional requirements, either on a single institution (at individual or consolidated level) or a category of institutions, to hold additional amounts of own funds and debt eligible for bail-in. According to the explanatory memorandum, this will, in particular, empower the NBB to take appropriate action with respect to small credit institutions, in accordance with the principle of proportionality.
- 1.6 The draft law also amends the Royal Decrees of 14 November 2008 and 22 April 2012 relating to the guarantee fund for financial services. In line with Directive 2014/49/EU of the European Parliament and of the Council<sup>7</sup>, the draft law introduces the concept of covered deposits, instead of

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3 See Opinion CON/2016/37 and paragraph 5.1 of Opinion CON/2017/1. All ECB opinions are published on the ECB's website at [www.ecb.europa.eu](http://www.ecb.europa.eu).

4 Explanatory memorandum, pp. 9 and 10.

5 Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012 (OJ L 257, 28.8.2014, p. 1).

6 Explanatory memorandum, pp. 38-44.

7 Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes (OJ L 173, 12.6.2014, p. 149).

eligible deposits, and adapts the ratio of individual contributions payable by credit institutions and brokerage firms upwards, so as to maintain the same level of overall contribution to the fund.

- 1.7 The draft law also amends the Law of 28 February 2002 to empower the NBB to impose new penalty payments on reporting institutions that fail to provide the information necessary for the establishment of balance of payments statistics. Currently, if reporting institutions fail to meet their obligations under the Law of 28 February 2002, the NBB may take a series of measures in order to obtain the information necessary for the establishment of balance of payments statistics that reporting institutions fail to share voluntarily. These include, inter alia, consulting the relevant documents onsite, interviewing members of the reporting institution and drawing up a report on the failure to comply. In respect of the consultation of documents onsite, the NBB may, following authorisation by a judge, without the permission of the reporting agent, have access to the buildings where such documents are kept. According to the explanatory memorandum, the existing mechanisms have proved cumbersome and inadequate. This explains why the Belgian legislator seeks to impose penalty payments, which are administrative measures expected to be efficient and straightforward as they will accumulate as long as the reporting institution has not complied with its obligations. A Royal Decree will determine the procedural safeguards to be complied with by the NBB when imposing such penalty payments.
- 1.8 Finally, the draft law amends the Banking Law to introduce a new category of unsecured creditors which, in the order of priority of creditors with competing claims over the assets of a credit institution or investment firm that is the subject of liquidation proceedings, will rank below ordinary unsecured creditors but above creditors holding subordinated debt. In order to belong to this new category, the debt instruments held must (a) incorporate a monetary claim against the credit institution or investment firm, the principal and interest of which are not contingent on the occurrence of an event that is uncertain at the time of issue (while floating-rate debt instruments are not affected by this restriction); (b) have a maturity of not less than one year; (c) be subscribed and/or held by professional investors; and (d) be subject to rules governing their issuance to the effect that the claim will rank below other unsecured creditors in accordance with the above-described new provision. According to the explanatory memorandum<sup>8</sup>, the purpose of this amendment, which is inspired by recent similar amendments in France on which the ECB was consulted<sup>9</sup>, is to facilitate the implementation of bail-in measures with respect to credit institutions, as the debt instruments falling within the ambit of this new category will be easily identifiable. Furthermore, loss-absorption by such debt instruments will mitigate possible contagion risks and adhere to the principle that no creditor should be worse off in resolution than in insolvency, as this particular ranking will also apply in the context of liquidation proceedings.

## 2. Preliminary comment

This opinion does not address the issue of whether the draft law effectively implements Directive 2014/49/EU in Belgian law. The focus of this opinion is on the various provisions of the draft law

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<sup>8</sup> Explanatory memorandum, pp. 29-38.

<sup>9</sup> See Opinion CON/2016/7.

relating to (a) the creation of a new category of senior non-preferred debt instruments in the insolvency hierarchy of credit institutions; (b) the introduction of new macroprudential tools; (c) the creation of a new category of settlement institution; (d) the exclusion of set-off rights with respect to credit claims pledged to the NBB; (e) the introduction of new penalty payments in the context of balance of payments statistics; and (f) the independence of the NBB's decision-making bodies with regard to financial stability matters.

### **3. A new category of senior debt instruments in the insolvency hierarchy of credit institutions**

#### *3.1 A new category of senior debt instruments*

3.1.1 The ECB welcomes the provisions in the draft law for the creation of a new asset class of 'non-preferred' senior debt instruments, which are senior debt instruments with a lower rank than ordinary senior unsecured claims in liquidation proceedings<sup>10</sup>. This lower rank is proposed to be achieved by establishing a statutory framework that recognises the contractual subordination arrangements contained in the rules governing the issue of such 'non-preferred' senior debt instruments by credit institutions and investment firms, where such debt instruments will rank before subordinated debt instruments but after other senior liabilities, including senior debt instruments and deposits, in liquidation proceedings.

3.1.2 Where the draft law requires that the principal and interest of such 'non-preferred' senior debt instruments are not contingent on the occurrence of an event that is uncertain at the time of issue, except as it relates to interest and can be calculated at any time according to a formula set out in the rules governing the issue of the debt instrument, some additional guidance to market participants in the form of an NBB regulation or a Royal Decree may be useful in order to enhance legal certainty.

#### *3.2 Effect on the loss-absorbing capacity of an institution in resolution*

3.2.1 Changing the statutory creditor hierarchy in bank insolvency proceedings is expected to enhance the loss-absorbing capacity of credit institutions in resolution, to the extent that they issue debt instruments belonging to this new category of 'non-preferred' senior debt instruments. The resolution authority may allocate losses in resolution to 'non-preferred' senior debt instruments prior to other senior liabilities, which will include operational liabilities such as corporate deposits and certain claims under derivative transactions. Imposing losses on 'non-preferred' senior debt instruments is regarded as carrying a lower contagion risk than that posed by operational liabilities, and will likely be more effective and appear more credible to market participants. The clear distinction in the insolvency ranking on a statutory basis created by the category of 'non-preferred' senior debt instruments will increase legal certainty regarding the ability of such debt instruments to absorb losses and, hence, help to minimise the risk of compensation claims under the principle that no creditor should be worse off in resolution than in insolvency. The presence of a layer of new 'non-preferred' senior debt instruments has the potential, depending on how substantial this layer is in a given institution, to foster effective resolution action and reduce the need for recourse to the

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<sup>10</sup> See paragraph 2.1 of Opinion CON/2017/6, paragraph 3.1 of Opinion CON/2016/28 and paragraphs 3.1 and 3.2 of Opinion CON/2016/7.

resolution fund. This is in turn expected to promote adequate pricing of risk for investors. The statutory recognition of contractual subordination is therefore expected to improve the resolvability of credit institutions under the Union resolution regime and enhance market discipline<sup>11</sup>.

3.2.2 In addition, the establishment of a statutory basis for the issuance of ‘non-preferred’ senior debt instruments, which include contractual subordination arrangements, may facilitate the application of MREL and TLAC requirements concerning the loss-absorption and recapitalisation capacity of credit institutions and investment firms<sup>12</sup>. As such, the draft law provides an additional means for credit institutions to comply with these requirements and improve their resolvability, without constraining their respective funding strategies. However, the draft law will not change the ranking of senior debt instruments that have already been issued, and requires newly issued debt instruments to contain an explicit contractual clause in order to be subordinated.

### 3.3 *Reform initiatives currently underway at Union level*

The ECB notes that a proposal for a directive of the European Parliament and of the Council on amending Directive 2014/59/EC as regards the ranking of unsecured debt instruments in insolvency hierarchy is currently under discussion<sup>13</sup>, and reiterates its position that a common framework at Union level on the hierarchy of creditors, including as regards the 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.

### 3.4 *General depositor preference*

3.4.1 The ECB considers that additional reforms would be useful to enhance the resolvability of credit institutions and 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, would enhance resolvability by clarifying the hierarchy of creditor claims and facilitating the allocation of losses to unsecured bank debt instruments ahead of certain operational liabilities, while alleviating concerns regarding the principle that no creditor should be worse off in resolution than in insolvency<sup>14</sup>. This would be complementary to the proposals set out in the draft law. It is worth noting that Member States are not precluded under Directive 2014/59/EU of the European Parliament and of the Council<sup>15</sup> from establishing general depositor preference rules in national law<sup>16</sup>, and recently a number of Member States have done so<sup>17</sup>.

11 See paragraph 3.1 of Opinion CON/2016/7.

12 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](http://www.fsb.org).

13 See Opinion CON/2017/6.

14 See paragraphs 1.4 and 2.3.1 of Opinion CON/2017/6, paragraph 3.1.2 of Opinion CON/2016/28, and paragraph 3.7.1 of Opinion CON/2015/35.

15 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).

16 See paragraph 2.3.1 of Opinion CON/2017/6 and paragraph 3.1.3 of Opinion CON/2016/28.

3.4.2 A general depositor preference, based on a tiered approach, could be achieved by introducing in national law another priority ranking for other deposits, such as large corporate deposits, deposits by credit institutions, collective investment undertakings, pension funds etc. Such deposits would rank below the higher priority ranking for deposits up to the EUR 100,000 coverage level, which are guaranteed by the deposit guarantee scheme, and the preference for certain eligible deposits held by natural persons or micro, small or medium-sized enterprises, but ahead of other senior liabilities<sup>18</sup>.

### 3.5 *Restriction to professional investors and resolvability*

The draft law stipulates that the new 'non-preferred' senior debt instruments may only be subscribed and/or held by professional investors, in accordance with the documentation rules governing the issuance of debt instruments. Given that the rationale for such a requirement is based on investor protection considerations and the desire to enhance resolvability, consideration should be given to addressing the issue in the context of the prospectus regime. The ECB notes that clear and easily understandable disclosure requirements and other safeguards that raise investors' awareness as to the risks associated with such instruments would be an alternative to restricting the investor base to professional investors. In the same vein, consideration could be given to requiring a minimum denomination per unit of each instrument of at least EUR 100,000, which would increase the investment hurdle and thus also the awareness of investors, thereby limiting direct retail investment. An impact study could be useful in this context to inform the policy decision taken. A common framework at Union level and a coordinated approach among Union and Member State authorities should be pursued on these issues. This would avoid different approaches being taken across Member States, and thus fragmentation within the Union market for these instruments. Finally, the ECB notes that the abovementioned rationale also applies with respect to retail investment in subordinated debt instruments, which will normally be subject to bail-in before the new 'non-preferred' senior class.

### 3.6 *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. Guideline (EU) 2015/510 of the European Central Bank (ECB/2014/60)<sup>19</sup> 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 that fulfil 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'<sup>20</sup>.

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17 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 No. 44/2016); and Article 145A of the Greek Banking Law (Law 4261/2014).

18 See Opinion CON/2017/6.

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

20 See paragraph 2.5 of Opinion CON/2017/6 and, in particular, paragraph 3.3 of Opinion CON/2016/7.

#### 4. **New macroprudential tool**

When applied to significant institutions, the proposed macroprudential tool to impose minimum funding requirements, including capital requirements, may interact with the ECB's supervisory powers. In this context, due care should be given to avoid doublecounting of risks. Furthermore, this new tool risks increasing the complexity of the institutional framework, blurring the division of responsibilities for setting adequate levels of capital requirements and loss absorption and recapitalisation capacity for individual credit institutions. It also risks further complicating the interplay of different prudential requirements.

#### 5. **A new category of credit institutions equivalent to settlement institutions**

The ECB understands that the establishment of a new category of institutions, whose business activity consists chiefly in the holding of financial instruments on their customers' behalf, is necessary as the current prudential framework applicable to institutions with such a business model does not address the specific risks stemming from such activity. The ECB therefore welcomes the extension of measures to mitigate such risks through the introduction of this new category of institutions, to which the NBB may apply supervisory tools akin to those applied to international and domestic central securities depositories.

#### 6. **Exclusion of set-off rights with regard to credit claims pledged to the NBB**

6.1 In line with its previous opinions regarding similar legal changes introduced under French<sup>21</sup> and Italian<sup>22</sup> law, the ECB welcomes the extension of the prohibition of set-off to the debtor of a credit claim pledged to the NBB in relation to the third party acquirer of such credit claim. With this change, the Belgian legislator protects the NBB against any potential loss arising from the acceptance of credit claims, thereby strengthening the requirement laid down in the second indent of Article 18.1 of the Statute of the European System of Central Banks and of the European Central Bank, pursuant to which lending by ESCB central banks must be based on adequate collateral. In addition, adequately addressing set-off risks also facilitates the continued eligibility of credit claims as eligible collateral in Eurosystem credit operations, and thereby contributes to the efficiency of the transmission of monetary policy to the real economy.

6.2 The ECB notes, however, that the prohibition of set-off by the debtor will only apply in its relationship towards a third party acquirer and the NBB, but not in respect of any other central bank of the ESCB. As a consequence thereof, another central bank of the ESCB, when acting as Correspondent Central Bank ("CCB") in the context of Correspondent Central Banking Model ("CCBM") under the laws of the Member State of that CCB on behalf of the home NCB (here NBB), as well as any other third party purchaser – would not be protected against set-off that may hence be applied by the debtor of such claim. The ECB understands that this approach currently does not give rise to legal risks in view of three elements. First, credit claims in Belgium are currently only

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<sup>21</sup> See Opinion CON/2016/37.

<sup>22</sup> See Opinion CON/2017/1, especially paragraph 5.1.

mobilised as collateral in Eurosystem operations with the NBB. Second, Article 6 of the Law of 3 August 2012 on various measures intended to facilitate the mobilisation of credit claims in the financial sector (hereinafter the 'Law of 3 August 2012') ensures that set-off may not be opposed after notification of recognition of the transfer of the credit claim. Third, Article 6 of the Law of 3 August 2012 ensures that set-off may not be opposed after the insolvency of the creditor of the transferred claims. Nevertheless, the Belgian legislator is encouraged to consider expanding the additional protection afforded to the NBB under the draft law to all other ESCB central banks, in order to support the growing use of credit claims at cross-border level in the future. In some Member States the relevant statutory provisions, similarly to the draft law, only exclude set-off rights for credit claims mobilised as collateral for operations with the NCB of that particular Member State. However, other Member States also have statutory provisions that provide protection not only for their own NCBs but also for the ECB and other ESCB NCBs<sup>23</sup>. The latter solution is preferable, as it offers a higher degree of financial protection to ESCB NCBs and promotes financial integration by facilitating cross-border mobilisation of credit claims.

#### **7. Penalties imposed by the NBB in the context of the balance of payments**

The ECB welcomes the draft law, insofar as it endows the NBB with the power to impose penalty payments on institutions that fail to comply with reporting requirements necessary in order to ensure the accuracy of balance of payments statistics.

#### **8. Decisions made by the NBB with regards to financial stability**

The ECB welcomes the change introduced by the draft to Article 22 of the NBB Organic Law to the effect that the Minister of Finance may not suspend or oppose any decision made by the NBB with regard to financial stability, which the ECB had previously recommended<sup>24</sup>.

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

Done at Frankfurt am Main, 8 June 2017.

[signed]

*The President of the ECB*

Mario DRAGHI

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<sup>23</sup> See paragraphs 1.1, 1.3, 2.3 and 2.4 of Opinion CON/2016/37.

<sup>24</sup> See paragraph 2.4 of Opinion CON/2016/55.