European Economic and Social Committee

ECO/429
Banking reform –
Creditor hierarchy in insolvency

OPINION

European Economic and Social Committee

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
[COM(2016) 853 final – 2016/0363 (COD)]

Rapporteur-general: **Daniel MAREELS**

Consultation	Council of the European Union, 03/01/2017 European Parliament, 16/01/2017
Legal basis	Articles 114 and 304 of the Treaty on the Functioning of the European Union
Section responsible	Section for Economic and Monetary Union and Economic and Social Cohesion
Adopted at plenary	22/02/2017
Plenary session No	523
Outcome of vote (for/against/abstentions)	169/0/3

1. **Conclusions and recommendations**

1.1 The EESC welcomes the Commission's proposal to amend the BRRD[1] or, more specifically, to establish a **harmonised national ranking of unsecured debt instruments in insolvency proceedings**. This proposal forms part of the wider package of recently published proposals for further banking reform[2]. The package essentially aims to transpose texts drawn up following work carried out within an international framework, such as the G20, the Basel Committee and the Financial Stability Board.

1.2 For the Committee, it remains imperative that the banking system is resilient and adequately capitalised as a prerequisite and basis for maintaining financial stability. At the same time, in the event of a bank crisis, it is essential that the private capital of shareholders and other bank creditors be called on in the first instance ("bail-in"), in order to avoid the need to call on public money or taxpayer funds. Employees' wages and pension benefits should also remain fully excluded.

1.3 The EESC welcomes the fact that the present proposal is being taken out of the aforementioned package and dealt with as a matter of priority (see point 1.1). Indeed, the recent development resulting in Member States legislating individually in this area and on the basis of their own interpretation may give rise to difficulties, for example when applying the "bail-in" regime. It is appropriate to change course and abandon the individual approach in favour of a harmonised approach at EU level, so that the same BRRD rules apply everywhere.

1.4 A harmonised approach will also prevent further distortions between Member States and undesirable competition in the market. The EESC deems it important to create a more level playing field between institutions and Member States and to reduce risks in the financial sector.

1.5 The Committee welcomes the fact that the proposal contributes to the robustness of the resolution mechanism and, at the same time, improves and may speed up its operational applicability.

1.6 The Committee believes there should be a loss absorption framework for all banks. In that regard, it is positive that the current proposal contributes to the implementation of specific measures for global systemically important banks. These require G-SIBs[3] to hold more loss-absorbing capacity, known as TLAC[4], which can be called on in the event of a crisis. This proposal also helps implement the bail-in regime for other banks by mitigating, where appropriate, any risk of legal debate.

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1 Bank Recovery and Resolution Directive.

2 In addition to the aforementioned text, that legislative package also includes amendments to Regulation (EU) No 575/2013 (the Capital Requirements Regulation or CRR), to Directive 2013/36/EU (the Capital Requirements Directive or CRD) and to Regulation (EU) 806/2014 (the Single Resolution Mechanism Regulation or SRMR). For references, see footnotes 8 to 10. On these proposals, see also EESC opinion ECO/424 currently in the pipeline (February 2017).

3 Global Systemically Important Banks.

4 Total Loss Absorption Capacity.

1.7 The Committee welcomes the incorporation of the abovementioned TLAC framework within the existing European requirements for all banks – the so-called MREL[5] – in such a way that all G-SIBs are subject to harmonised rules. Furthermore, incorporating them into a single framework will also help improve the effectiveness and efficiency of the resolution process.

1.8 Banks have a very important role to play in financing the economy, and in particular households and SMEs. The potential negative impact on banks' funding costs should therefore be minimised. At the same time, the new rules should not only facilitate and broaden as far as possible the issuance of the unsecured debt instruments in question, but also offer the greatest possible clarity and legal certainty to all parties, including investors. It is important that the consumer protection rules are both fully applicable and applied in practice.

1.9 The proposed approach whereby the new rules are only applied to future issuances of the debt instruments concerned appears to be the most realistic option and can thus also be supported.

2. Background[6]

2.1 The present proposal[7] is part of a package of five legislative proposals[8] concerning banking regulation recently published by the Commission, which builds on existing legislation in this area[9]. It is now being taken out of the package and brought forward with a view to speeding up adoption and implementation.

2.2 This package aims to transpose texts drawn up following work carried out by the Basel Committee on Banking Supervision and the Financial Stability Board, also taking into account the results of the Commission's call for evidence, which was aimed at assessing the effectiveness and efficiency of current banking law.

2.3 Generally speaking, this package of proposals is essentially designed to:

2.3.1 increase the resilience of the EU financial institutions and foster financial stability;

2.3.2 improve the lending capacity of banks in order to support the EU economy; and

2.3.3 promote the role of the banks in achieving deeper and more liquid European capital markets, in order to support the creation of a capital markets union.

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5 Minimum Requirement for Eligible Liabilities and Own Funds.

6 This text is based, among other things, on the information provided by the Commission (e.g. press release and Q&A) on the package and the proposal currently being discussed.

7 COM(2016) 853 final.

8 As of 23 November 2016. See http://europa.eu/rapid/press-release_IP-16-3731_en.htm.

9 The package includes amendments to:

- the Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD) of 2013. These set out prudential requirements for credit institutions (banks) and investment firms and rules on governance and supervision;
- the Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism Regulation (SRMR) of 2014. They include the rules on the recovery and resolution of failing institutions and establish the Single Resolution Mechanism.

2.3.4 At the same time – and it is appropriate to mention this here – the proposals aim for a more sophisticated and comprehensive application of the proportionality principle for the benefit of small and/or non-complex banks.

2.4 Against this backdrop, the present proposal aims to create a harmonised national ranking of unsecured debt instruments. This is important for the resolution of a bank under the BRRD framework.

2.5 In the event of such a resolution, it is important that losses are in the first instance borne by private capital and not by taxpayers or governments. This is achieved through a "bail-in", i.e. writing off debts or converting them to risk capital.

2.6 To this end, all banks must have a minimum level of equity and eligible liabilities, i.e. they must comply with the MREL requirements.

2.7 A new element is that now international agreements have been reached regarding additional requirements for global systemically important banks (G-SIBs), as part of efforts to tackle the "too big to fail" issue. One of the other abovementioned proposals of the package of measures seeks to incorporate this very requirement, known as total loss-absorbing capacity (TLAC), into the existing MREL system for these banks.

2.8 Both obligations have already encouraged a number of Member States to adapt[10] their insolvency laws at national level to the ranking of certain bank creditors.

2.9 This adaptation is being carried out in varying ways in the Member States, which is not ideal and not entirely desirable in the light of the objectives set. The present proposal aims to remedy this by introducing a harmonised regime (see 2.4).

3. Observations and comments

3.1 Overall, this package of measures and the proposal under consideration are to be welcomed. They further complement and refine the important reform efforts that were undertaken following the crisis to strengthen the financial sector. They also help to further reduce risk in this sector.

3.2 Overall, the important thing is that the banking system is resilient and sufficiently capitalised. That in turn is important for maintaining financial stability. Stability requires that, in the event of a bank crisis, the private capital of shareholders and other bank creditors be called on in the first instance ("bail-in"). This approach should avoid the need to resort to public money or taxpayer funds. Employees' wages, pensions and other fixed remuneration should also remain safeguarded in any case[11].

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[10] Others are in the process of making similar adaptations.

[11] In accordance with Article 44(2)(g)(i) BRRD.

3.3 This approach should be applied fully to all banks. In this respect, the EESC is pleased that work is also being carried out on a more robust scheme for global systemically important institutions (G-SIBs), in line with agreements reached at G20 level.

3.4 It is positive that this proposal integrates the TLAC system into the existing MREL requirements, as provided for in the BRRD. Not only does this improve the application of the existing rules, but it also lays the foundation for a harmonised regime for the largest significant banks. That will in turn have a positive impact on the operational applicability of the regime.

3.5 Given the very important role banks play in financing the economy, particularly households and SMEs, the issuance of instruments of this kind should be done under the right conditions and as broadly as possible. The new system helps to provide clarity and legal certainty for all parties, including investors. Attention must also be paid to costs. The new rules should minimise the potential negative effect on the funding costs of banks.

3.6 The fact that a number of Member States have very quickly begun making the adjustments to national insolvency law in order to take account of developments at European and international levels (see above) is in itself very positive.

3.7 Unfortunately, this has been done in varying ways, leading to significant differences between the Member States and also to a number of adverse effects, such as uncertainty for issuers and investors and their treatment in the event of the bail-in regime being applied. This may also hinder the application of the BRRD framework to banks that operate in more than one country.

3.8 In the Committee's view, it is not desirable for varying treatment of unsecured debt instruments to exist here, which, moreover, would lead to distortions between financial institutions and Member States and result in unwanted competition in the market.

3.9 Swift action is therefore desirable and the challenge is not only to stop Member States adopting individual approaches, but more specifically, to move towards a harmonised approach. This would not only lead to a more level playing field between institutions and Member States but also contribute more effectively to the pursuit of the fundamental objectives of greater financial stability and a reduction of risks in the financial sector.

3.10 The new regime contains no provisions relating to the possibility (or not) for certain investors to purchase or acquire these unsecured debt instruments. It is probably not appropriate to deal with this issue in the BRRD and, moreover, the important thing is ultimately for consumer protection[12] in this area to be fully applicable and that it can be given full effect in practice.

3.11 This regime only applies to future issuances and not to the existing stock. For the sake of legal certainty and – perhaps unintended – effects on the markets, issuers and investors, this would appear to be a reasonable approach, even though there may (temporarily) be certain consequences for regulators.

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12 See the MiFID and MiFID 2 rules. The latter shall enter into force at the beginning of 2018.

3.12 Finally, it would also seem appropriate to aim for a realistic date of entry into force[13].

Brussels, 22 February 2017

Georges DASSIS
The president of the European Economic and Social Committee

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13 The current texts provide for 1 July 2017. The question arises as to whether or not that is feasible.