# Summary Report of the 27th Meeting of the Commission Expert Group on Banking, Payments and Insurance

The representative of the Commission's services (EC) recalled the deadline for the transposition of the BRRD and the consequences of not transposing it. 9 MSs have fully transposed. 11 MSs (*mentioned at the meeting*) have received reasoned opinions. This issue will also be mentioned at the ECOFIN of June 19.

The purpose of the meeting was to discuss bail-in, MREL and national proposals which intend to amend the insolvency ranking of banks' creditors. The EC recalled the invitation of the FSC to the COM to coordinate the discussion among Member States.

The EC mentioned the need to discuss how bail-in will be applied in practice and how it could be operationalized under Article 44 of BRRD. It recalled the NCWO principle of BRRD. It also recalled the *pari passu* principle imbedded in the BRRD and the possibility to deviate from it provided that the NCWO principle is preserved. TLAC is a requirement which is equivalent to MREL and has the same policy objective. The difference is that TLAC is calibrated for G-SIBs. MREL is for all banks. He mentioned the risks recalled at the FSB level of breaching the *pari passu* in bail-in. This is reflected in the TLAC term sheet which excludes senior debt. Some national proposals by juniorizing senior debt would facilitate the application of bail-in and avoid breaching the NCWO.

A Member State asked if the meeting is meant in view of a possible review of BRRD in 2016.

The EC stated the need to look at specific proposals from Member States. This is a fact-finding exercise. We have to build on the BRRD TS. Then, there are also the international discussions. FSB will discuss this issue after the summer. Then BRRD could be reviewed.

A Member State (**MS**) presented its proposal on subordination. It has adopted this proposal to facilitate the application of bail-in and improve the resolvability of banks while respecting the NCWO principle. In order to comply with the NCWO principle, it would be necessary to bail-in all seniors. But this would create problems for financial stability. Therefore, the RA might make use of its right to exclude derivatives. But this could breach the NCWO and will have legal consequences. This situation might discourage application of the bail-in tool to senior unsecured. To address this problem, the **MS** is proposing a statutory subordination.. The **MS** proposal wants to introduce a layer of senior unsecured debt (capital markets instruments which are tradable) in the insolvency ranking as bail-inable. This does not exclude derivatives from bail-in. It does not primarily aim at implementing TLAC or MREL. More work needs to be done on these issues. The proposal will increase

transparency and legal certainty... The Ministry of Justice (MoJ) in that **MS** does not oppose the change in insolvency law. MS considers the proposal to be compatible with EU human rights as well as the MS constitutional law, as it affects a future, contrary to an existing, claim. BRRD is not amended. Legislator is not prevented from changing the insolvency ranking. This is an artificial retroactivity and the public interest should prevail. BRRD already affects the rating of banks and the probability of default (PD). But the **MS** proposal increases transparency and facilitates bail-in. At the time being, there are no massive repercussions on institutional/retail investors expected. Retail investors are already preferred (insured deposits). Rating agencies do not expect a major downgrading. Not all banks have the same funding structure. Risk of refinancing senior surplus into structured notes to save funding costs should be small. There is the possibility that the refinancing could be done with more volatile instruments. But the effects should be limited because investors should not be able to easily swap instruments. The proposal is very timely because TLAC will require some time to be implemented and it is important to ensure the operationalization of bail- in also short term and middle term. The proposal should enter into force in 2016.

The EC asked whether the **MS** Parliament could amend the proposal.

The **MS** confirmed that the Parliament could of course change the proposal. The outcome is still open.

A Member State welcomed the discussion. This is very relevant for the transposition of the BRRD. The hierarchy of claims in the balance sheet of banks is important and therefore there are some concerns about divergences in national laws. The Member State is very open to discuss this matter. Question: The **MS** proposal on statutory subordination is distinguishing among eligible liabilities, but there is also an issue of eligible/non eligible which in insolvency rank *pari passu*. This is also an important issue. The outcome should be the same in insolvency and in resolution. There is also a question of scope because the **MS** considers that small banks will never be resolved.

A Member State asked a question on the structure and cost of funding. Did the analysis take into consideration the residual maturity of the outstanding debt? At maturity, the cost of funding should be relatively higher.

A Member State supported the objective but it had some concerns on the impact on the cost of funding. Main issue is that in the short term the proposal of statutory subordination would increase the loss absorbing capacity. But for banks with a lot of senior debts there could be a substitution effect.

The **MS** explained that harmonization or coordination would be ideal in this field. Until now BRRD is neutral in relation to insolvency law. Open to make it compatible with other Member States. One of the reasons to include all banks is that there is no legally certain and transparent way between potentially systemically relevant and

other institutions. The insolvency ranking would stay as it is. There would be simply an additional line between senior debts in insolvency.

A Member State asked if eligible/non eligible in BRRD would rank *pari passu* under the proposal of statutory subordination. How non eligible would be treated, short term debt for example?

The **MS** stated that there would be only an additional next step among senior. It does not want to create the wrong incentives and create substitution effects. It does not think the risk for substitution effects all too significant.

A Member State is still analyzing the impact of the proposal. It is assessing ex post effects: there will be more clarity on the order of liabilities; but there is also the issue of restricting the discretion of the NRAs. The NRAs would have less choice on the pool of bail-inable instruments. The Member State wants to avoid the risk of changing the funding models (i.e. ex ante effect) and creating volatility. There is also a question of classification of liabilities. In its views structured notes can be bailed in: NRAs will learn how to do it. More assessment is needed. Even if, theoretically, statutory subordination should be neutral on the global funding cost of a G-SIB, in reality, the elasticity of the investor bases are such that the increase in the cost and the volatility of the subordinated tranche will not be offset by a theoretical decrease in the cost of the tranche that is not subordinated. More analysis is needed on banking structure.

A Member State welcomed this discussion. It prefers an EU approach. Harmonization or coordination would be needed. It also prefers a statutory approach. It is surprised by the moderate impact on the funding model as presented by the **MS**. Interested in hearing more about the implications. A clear cross-sector assessment of the impact is needed. The Member State asked questions on the effect on the eligibility as collateral with the ECB for example.

The EC asked questions on the necessity to clarify which liabilities would be subordinated. Moreover, what about the *pari passu* clauses and the bonds issued under foreign law.

The **MS**: under BRRD, the RA operates and applies discretion within the framework of national insolvency law. The **MS** is curious to know the position of the SRB and of the NRAs. Paper issued under foreign jurisdiction would be covered if the institution is subject to the **MS** insolvency law. As for the *pari passu* clauses, it is necessary to look at the specific clause – the usual pari passu clauses are not triggered by changes in law. On cross-border effects: if the institution is from the **MS** and it is located in the **MS**, the ranking would apply wherever the investor is located. In the EU, the same applies to subsidiaries in the MS, this is determined by the winding-up directive. The problem is more with third-country jurisdictions. But this is a problem which already exists. There would be a parallel proceeding in the third

country jurisdiction. On the impact on investors, this is an important point. It is difficult to get real numbers. Solvency II will also change the rules of the game.

The ECB is assessing the **MS** proposal of statutory subordination. They are aware that this proposal might impact the eligibility of certain liabilities as collateral. A subordination clause could indeed impact the eligibility under the existing documentation. In terms of impact, the ECB agrees that the impact should be limited. The internal assessment of the ECB tends to be positive for the implementation of bail-in. It could be a useful blueprint for the operationalization of bail-in set aside the question of collateral policy, also in view of the TLAC developments.

A Member State asked questions on the impact on investors and in particular on possible limits on banks. It referred to the TLAC requirements. The assessment of the impact on capital is still ongoing. The market for these securities can be very limited.

The EC stated that it is assessing the proposal also from a Human Rights (HR) point of view.

A Member State had concerns on the impact on existing funding model. On the Member State's proposal for subordination, this Member State questioned the focus on derivatives and the difficulty of ensuring respect with NCWO principle. It recalled BRRD art 44(3)(d) foreseeing the possibility of bailing-out liabilities when the value destructed with bail-in would be higher than the gains obtained through it (this could be the case of some derivatives' portfolios given the relatively low amount of exposures and the close-out netting provisions upon bail-in, which would potentially leave the bank temporarily unhedged and facing re-hedging costs). In this case, with all creditors better off following the bail-out, it would be easy to prove the respect of the NCWO principle. On the structural notes, it said it agreed with the point raised above by another Member State. This is different from derivatives and complexity is lower.

The MS explained that BRRD had changed the ranking. What would happen with contractually subordinated debt? It should stay where it is. The MS has assessed concerns on HR in EU law as well as in their Constitutional Law. ECJ distinguishes between retroactivity and artificial retroactivity. It is necessary to look at proportionality. Bonds concerned are already possibly subject to bail-in. ECHR case law – difficult to find an exact parallel but *Bäck v. Finland* indicates the interference to be justified. They will be in contact on this important issue.

A Member State welcomed this meeting. It supports the proposal of statutory subordination. Some concerns like other Member States (retroactivity and impact on funding model/level of senior debt). It should be assessed how it will affect the funding. The EC should lead this change independently from the way and instrument.

A Member States considers that theoretically speaking, the proposal of statutory subordination makes sense. Main concerns would be the cost of funding and the impact on investors. EU solution is ideal. It should be considered in the review of MREL.

A Member States had an observation and question for EC. Discussion should not exclude contractual subordination. Structural subordination is also possible. Many Member States are still transposing BRRD. It supported the position of a Member State stated previously (i.e. avoid the risk of changing the funding models and creating volatility). More time is needed and EBA should do its work. No solution at this stage. Concerned about the fast track solution of statutory subordination. But NRAs can ask banks to require structural or contractual subordination. It gave the advice to wait for the TLAC requirements and work at the EBA.

The EC clarified that the BRRD DA content was different because it covered exclusion from bail-in. It is then different from the **MS** statutory subordination proposal which is about insolvency ranking.

EBA did not want to comment on this proposal. But they are looking into this issue and would be happy to participate in the impact analysis. They would welcome to receive a mandate to conduct the analysis. There is the impact on funding cost. Rating agencies are looking into the LGD. There could be an impact in the transitional period. There could be increases of cost. We expect major impacts in the transitional period during the period of fulfillment of the MREL. Substitution effect is also a concern and should be assessed in a more general context: how this is linked to MREL and whether MREL is a sufficient solution; what are the investor basis and potential use as collateral. This has also an impact on funding costs and on banks holding that debt. Certainty on the categorization of liabilities is also to be clarified – complicated question also for debt issued under non-**MS** law. Debt could be eligible for MREL but rank senior in insolvency. It requires input from experts: definition of MMI.

The **MS** has gone through a public consultation. They are optimistic about the fact that the proposal catches the right instruments. But inputs from EBA are welcome. Public hearing is on July 1. Comments will be published soon after the July 1. The proposal is not revolutionary because of bail-in provisions which are already there. PD does not change. LGD might change. Rating might change. The **MS** proposal is a minor step in the revolutionary change of the bail-in.

A Member State made a presentation about the changes in this Member State to transpose the BRRD. In the coming days the law will be published in the Official Journal. Before BRRD, there was not differentiation between certain capital instruments. Is has simply created a layer among subordinated debts. But they have not touched the senior. The main consideration is to make bail-in workable and avoid confusion and litigation due to NCWO.

A Member State asked if the Member State proposal to create a layer among subordinated debt (see. above) introduces the possibility of contractual T3. Will this change facilitate implementation of TLAC?

The Member State (that plans to create a layer among subordinated debt) said it had no intention to create an additional asset class. It purely intended to take into account contractual differences between Tier 1 and 2 also in insolvency law.

A Member State asked why was it considered needed. Isn't the contractual subordination already clear? Is it only a clarification?

The Member State (that plans to create a layer among subordinated debt) said the change reflected the case law and would provide some clarity.

A Member State asked question about the interpretation of Article 48 of BRRD.

SRB asked question on T2 and the amortization period.

The Member State (that plans to create a layer among subordinated debt) reiterated it would have no change on T2. So there should be no impact.

COM clarifies that BRRD is clear on the way bail-in should be applied to capital instruments. COM has also to look at CRR which as Regulation would apply. As for the SRB question, the T2 is part of the guidelines.

In the afternoon session, EC asked (i) if Member States are considering adopting similar proposals, (ii) whether Member States are concerned about the possible unlevel playing field determined by different national laws, (iii) how the issue could be brought forward at the EU level. COM intends to report back to the FSC.

A Member State said that statutory subordination would be a new issue implying that the MoJ would also have to be involved. This Member State would not go alone without an EU approach. If subordination helps, an EU approach should be followed. Divergences would not help cross-border resolutions. These are only preliminary views.

A Member State is still assessing the proposal of statutory subordination, which seems to be a viable solution. However, more assessment is needed. If an initiative needs to be taken, it will have to be an EU solution amending L1 of BRRD. Harmonization at EU level would be needed. Statutory subordination will give legal certainty provided it is legally sound.

A Member State said no initiative at national level was envisaged at this stage. It raises concerns about the level playing field in cross-border resolution.

A Member State is still assessing the proposal of statutory subordination. No EU initiative is necessary. Further assessment is needed.

A Member State said that before the national elections there was no intention to pass national law in this respect. The Member State is concerned about the change in funding model. It said its banks are not structural subordination.

A Member State said it would prefer an EU approach which would put pressure on MoJ. A common approach is needed at least in the Banking Union.

The **MS** said that it would prefer an EU solution or a coordinated approach among Member States.

A Member State said it shared the objective to operationalize bail-in. It has legal concerns and economic concerns on the **MS** proposal of statutory subordination. An impact assessment is needed before an EU initiative is brought forward. Coordination is needed on the TLAC discussions, and in any case, the delegated act under Article 44(3) of BRRD should be published as soon as possible given its role in the design of the TLAC proposal. We do not need to wait the conclusions of the discussion on the opportunity of a statutory subordination, given that the latter would not change the substance of Article 44(3).

A Member State said it had solution at national level. But it is open to explore options. However, the work on MREL should advance without waiting for the FSB results. It considers that the **MS** proposal of statutory subordination is compatible with Article 44 of BRRD. An IA is needed. This has to assess balance sheets of banks. It has to provide some insight on the legal issues.

A Member State reiterated it had no intention to create an additional asset class. It said it intended to take into account contractual differences between Tier 1 and 2 also in insolvency law.

A Member State said it was for the Ministry of Finance to decide. Central bank sees the MS proposal of statutory subordination favorably. An EU solution is preferable.

A Member State said BRRD needed to be implemented as soon as possible.

A Member State said the **MS** proposal of statutory subordination would not be relevant for all banks.

A Member State said an IA would be needed and a EU approach is also needed.

A Member State said an IA was needed. An EU solution is needed to preserve the single rule book.

A Member State said it favoured an EU solution.

A Member State said it had no formal position yet. It is also considering other options like structural subordination. An IA is needed.

A Member State said it had also no formal position yet. It welcomes further discussion at the EU level. But further assessment is needed. Also other options need to be considered.

A Member State said it had also no formal position yet as internal discussion at technical level was still at an early stage. Banks in that Member State are concerned about the possibility of compliance of MREL with subordinated debt being required. Further assessment is needed regarding if and how to address the issue. In case a need to act on this field is identified, this Member State would tend to favor a solution as harmonised at EU level as possible.

A Member State said there had been no discussion on this point yet. It would be useful to have a proposal for a roadmap on the process relating MREL, TLAC and subordination. An EU solution would also be preferable.

A Member State said structural or contractual subordination should remain options. As for the harmonization, there is also an issue of unlevel playing field between structural, contractual and statutory subordination. Even within a Member State there are different approaches. An IA would be needed.

*The member state considered that a harmonised approach was not necessary at this stage and that any impact assessment should consider also the contractual and structural approaches to subordination; the most appropriate form may vary between member states and between firms within member states. Although further analysis could usefully be done by the group, it would be important that moves at national level to make banks resolvable across the Union are not delayed.*

***Conclusions:***

- Hierarchy of claims is a key element. No disagreement with this.
- A general feeling that more work is needed: (i) discussion should continue; and (ii) there is a call for a IA, including on the alternative options, balance sheet structures, funding models, investors, legal basis, retroactivity.
- COM will work on a draft mandate with the EBA by the end of this week to finalize the work by the end of July/September.
- There is no intention to legislate on this issue at the moment. However, it would be helpful to have a roadmap on this issue.
- Minutes of the meeting will be discussed at the EFC and FSC.