5 The Reform of Bank Creditor Hierarchy in the EU

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On November 23, 2016, the EU Commission published a legislative proposal amending Directive 2014/59/EU (« BRRD ») to modify creditor hierarchy in insolvency with a view to facilitating the resolution of EU credit institutions. The proposal, which was fast-tracked, resulted in the adoption of Directive (EU) 2017/2399 of 12 December 2017 (the « Directive »), which amends BRRD as regards the ranking of debt instruments in insolvency and is required to be implemented by Member States by 29 December 2018.

The Directive introduces a new rank in insolvency for ordinary, long term, unsecured debt instruments issued by credit institutions, investment firms, financial holding companies and financial institutions within their consolidation perimeter that are established in the EU. These so-called « senior non-preferred » instruments will rank senior to regulatory capital but junior to other senior liabilities.

This proposal is designed to improve the resolvability of EU institutions. In particular, it will, in line with the objectives of the Financial Stability Board's « Total Loss Absorption Capacity » (TLAC) standard [1] and the BRRD »s « Minimum Requirement for Own Funds and Eligible Liabilities » (MREL), allow resolution authorities to bail-in senior ordinary bonds in priority to other senior liabilities, rather than being required, as is currently the case under BRRD, to bail-in all simultaneously and on a *pari passu* basis all senior liabilities, including operational liabilities, derivatives and deposits, which are as a practical matter difficult to bail-in [2].

The Directive builds upon legislation recently enacted in certain Members States including France, Germany and Italy, and closely aligns with the 2016 French « Sapin 2 » law.

1. The Existing EU Framework

1 - The BRRD framework currently requires capital and debt instruments of an entity in resolution to be written down or converted in accordance with the following loss-absorption waterfall :

- *first*, Common Equity Tier 1 items ;
- *second*, Additional Tier 1 instruments ;
- *third*, Tier 2 instruments ;
- *fourth*, subordinated debt that is neither Tier 1 nor Tier 2 capital, in accordance with the hierarchy of claims in insolvency under national law ;
- *fifth*, other eligible liabilities, in accordance with the hierarchy of claims in insolvency under national law ;
- *sixth*, deposits from natural persons and micro, small and medium-sized enterprises that exceed the amount of covered deposits ;
- *seventh*, covered deposits and deposit guarantee schemes subrogated to their rights. [3]

Claims within the same rank in the above waterfall must be reduced *pari passu* among themselves. [4] In addition, the « no creditor worse off » principle applies, *i.e.* creditors must not suffer a worse treatment in resolution than they would have suffered in insolvency and are entitled to compensation for the difference. [5]

As an exception to the *pari passu* treatment, certain categories of eligible liabilities can be excluded from the resolution waterfall pursuant to Article 44(3) BRRD in certain exceptional circumstances, *e.g.* if (i) the liability cannot be bailed-in within a reasonable time ; (ii) the exclusion is strictly necessary to ensure critical functions and core business lines ; (iii) the exclusion is strictly necessary to avoid widespread contagion, especially with respect to eligible deposits, that would cause a serious disturbance to the economy of a Member State or the Union ; or (iv) the application of the bail-in tool to those liabilities would cause a destruction in value such that the losses borne by other creditors would be higher than if those liabilities were excluded from bail-in.

However, the Article 44(3) exclusions remain subject to the « no creditor worse off » principle. Accordingly, where a resolution authority decides to exclude or partially exclude an eligible liability or class of eligible liabilities under this provision, the level of write down or conversion applied to other eligible liabilities may be increased to take account of such exclusions, to the extent the holders of such eligible liabilities do not suffer a greater loss than they would have suffered in insolvency.

As a result, except under Article 44(3) (which may, however, give rise to indemnity claims under the « no creditor worse off » principle and is therefore not optimal from the standpoint of the resolution authority), the BRRD framework does not allow resolution authorities to bail-in certain liabilities in priority to others if those liabilities have the same rank under national insolvency law.

Specifically, in situations where senior liabilities must be bailed-in (i.e. where the entity's regulatory capital does not

1. *See the FSB, Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution. Total Loss-absorbing Capacity (TLAC) Term Sheet, Nov. 9, 2015, available at www.fsb.org/wp-content/uploads/TLAC-Principles-and-Term-Sheet-for-publication-final.pdf.*
2. The proposals published by the Commission on November 23, 2016 would also modify the BRRD, Regulation 2014/806/EU (SRMR) as well as Directive 2013/36/UE (CRD IV) and Regulation 2013/575/UE (CRR) to implement TLAC requirements and, more broadly, align TLAC and MREL requirements.
3. *See Articles 47 and 48(1) and 108 BRRD ; Article 17 SRMR.*
4. *See Articles34(1)(f) and 48(2) BRRD ; Article 17 SRMR.*
5. *See Articles 34(1)(g) and 73 BRRD.*

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provide a sufficient cushion to absorb losses), the BRRD does not allow resolution authorities to bail-in senior debt investors in priority to holders of other senior liabilities such as operational creditors, holders of derivative liabilities or depositors.

Under the current framework, resolution authorities are therefore faced with the following alternatives in the most critical situations, i.e. where an institution's regulatory capital is insufficient to absorb losses : **(1)** bailing in senior liabilities, in which case all senior liabilities must be bailed-in *pro rata* (including operational liabilities, derivatives and eligible depositors), which may result in political risk, financial contagion and litigation ; **(2)** excluding certain liabilities (such as derivatives, operational liabilities or retail depositors) from bail-in under Article 44(3) BRRD, which may result in litigation and indemnification pursuant to the « *no creditor worse off* » principle or **(3)** seeking to avoid placement in resolution and bail-in altogether.

In most of the post-BRRD banking crises where a bail-in of senior liabilities would have been required to absorb losses, resolution authorities have, perhaps unsurprisingly, sought to avoid resolution and bail-in altogether and reverted to the pre-BRRD method of addressing banking crises, i.e. taxpayer funded bailouts, with the holders of subordinated debt being subject to burden sharing under State aid rules, thereby calling into question the effectiveness, credibility, and usefulness of the BRRD framework.

This was the case in particular with respect to (i) the Greek banks recapitalized by the State-owned Hellenic Financial Stability Fund in November 2015 under the « precautionary recapitalization » exception provided in Article 32(4) of BRRD (ii) Banca Monte dei Paschi di Siena, recapitalized by the Italian State in July 2017 under the « precautionary recapitalization » exception provided in Article 18 of SRMR and (iii) Veneto Banca and Banca Popolare di Vicenza, placed in liquidation in June 2017 under the « national insolvency » rule provided in Article 18 of SRMR. [6]

The cases in which placement in resolution did occur did not require a bail-in of senior liabilities and/or have resulted in protracted litigation. [7]

The Financial Stability Board anticipated the potential impediment to resolvability resulting from the *pari passu* principle illustrated by these cases, and put forward the TLAC standard in November 2015. The TLAC standard requires global systemically important banks (G-SIBs) to hold a minimum amount of « minimum external loss-absorbing capacity » (« Minimum TLAC ») in the form of resources that are either regulatory capital or « loss-absorbing » liabilities, i.e. liabilities that (i) have a remaining maturity of at least one year, (ii) do not consist of certain excluded liabilities (covered or short term deposits, derivatives, structured notes, preferred or secured liabilities, liabilities that are legally excluded from bail-in or cannot be bailed-in without giving rise to material risk of successful legal challenge or indemnity claims) and (iii) are subordinated (including through a junior rank under insolvency law) to such excluded liabilities.

2. The Directive

A. - Overview

2 - The Directive implements the TLAC principles in the EU framework by requiring Member States to introduce a new statutory senior non-preferred rank in insolvency for credit institutions, investment firms, financial holding companies and financial institutions within their consolidation perimeter that are established in the EU.

In order to be eligible for senior non-preferred rank, liabilities must have the following characteristics :

- they must be *unsecured claims arising out of debt instruments* (*i.e.* bonds and other forms of transferrable debt and instruments creating or acknowledging a debt) ;

- their *contractual documentation* must expressly refer to this ranking ;

- their *initial contractual maturity must be at least one year* – In its March 8, 2017 opinion, the ECB recommended that institutions « should be allowed to issue 'non-preferred' senior debt instruments with initial maturities that are either more than or less than one year, » the argument being that – even if instruments with an initial or residual maturity of less than one year would not be eligible for MREL or TLAC purposes – they would still be bail-inable and, therefore, increase the institution's capacity to absorb losses. [8] In its report dated July 4, 2017, [9] the European Parliament's Economic and Monetary Affairs Commission (« ECON ») followed the ECB recommendation and proposed to not set a minimum maturity requirement. [10] The Directive, however, maintains the one-year minimum maturity requirement ;

- they must neither be *derivatives nor contain embedded derivatives* – Following the ECB's recommendation that « what constitutes a derivative feature » be clarified, [11] the Directive provides that debt instruments with variable interest derived from a broadly used reference rate such as Libor or Euribor (i.e. floating rate debt instruments) and debt instruments not denominated in the domestic currency of the issuer (provided that principal, repayment and interest are denominated in the same currency), shall not be considered to be debt instruments containing embedded derivatives solely because of those features. The Directive does not reflect, however, amendments that sought to allow debt instruments with derivatives features to qualify as

6. For a description of the application of BRRD/SRMR and State Aid rules in the Greek and Italian cases, see *The Commission is playing with fire* (Amélie Champsaur, IFLR, August 2016) and *The liquidation of the Venetian banks : loophole or circumvention of the EU rules ?* (Amélie Champsaur, IFLR, October 2017).
7. The resolution of four regional Italian banks in November 2015 led to a public outcry due to the fact that a large amount of subordinated instruments written-down in the context of the resolution were held by retail depositors, with these instruments having allegedly been sold to such depositors without appropriate warnings as to the risk of loss. Since it was not possible under BRRD to not bail-in those retail debt holders (whose subordinated instruments ranked *pari passu* with subordinated debt held by institutional investors), the Italian government resorted to an *ex post* indemnification mechanism. While Banco Popular (Spain) was subject to resolution under BRRD rules, regulatory capital and the intervention of a third party acquirer were sufficient to absorb losses and recapitalize the bank such that the bail-in of senior debt was not necessary. In the HETA Asset Management case (Austria) bail-in was applied to senior liabilities of a defeasance entity which did not have any deposits. These cases, as well as the Novo Banco case (Portugal), in which Article 44(3) was reportedly used, have all led to litigation by affected creditors against resolution authorities.
8. *See* ECB opinion 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), dated March 8, 2017 (available at *www.ecb.europa.eu/ecb/legal/pdf/en_con_2017_6_with_twd.pdf*), Para. 2.1.1.
9. Available at *www.europarl.europa.eu/sides/getDoc.do ?pubRef=-%2f%2fEP%2f%2* fNONSGML%2bCOMPARL%2bPE-606.264%2b02%2bDOC%2bPDF%2bV0%2f%2fEN.
10. *See* ECON draft report dated July 4, 2017, Amendments Nos. 9 and 20, as well as the accompanying Explanatory Statement.
11. *See* ECB March 8, 2017 opinion, *cit.*, Para. 2.1.2.

senior non-preferred instruments, to the extent that they are MREL-eligible under (proposed) Article 45b(2) BRRD. [12]

The new rank will be eligible for instruments issued after the entry into force of national measures implementing the Directive, subject to grandfathering provisions taking into account regimes implemented in certain Member States prior to 31 December 2016 in order to implement the TLAC standard, as well as measures adopted by Member States after 31 December 2016 to anticipate on the adoption of the Directive. [13]

Given that senior non-preferred instruments are designed to absorb losses in priority to other senior liabilities, ECON had proposed several amendments driven by the wish to protect investors buying those instruments, ranging from specifying that senior non-preferred instruments shall qualify as « complex » under Article 25 of Directive 2014/65/EU (« MiFID II ») [14] to proposing that « [o]nly professional clients should be allowed to purchase » such instruments. [15] These principles, while not incorporated in the Directive, are in any event – at least, in part – reflected in ESMA's guidelines on complex debt instruments and structured deposits, which provide that all « debt instruments eligible for bail-in tool purposes » are to be deemed complex. [16]

The ECON draft report dated September 8, 2017 also proposed to add an additional rank consisting of debt instruments, which would rank senior to senior non-preferred debt but junior to all other ordinary unsecured claims [17]. This proposal was in line with the ECB recommendation to introduce « a general depositor preference, based on a tiered approach ». [18] It was, however, not reflected in the Directive, which maintains a preference for covered deposits as well deposits from natural persons and micro, small and medium-sized enterprises but does not introduce a general preference covering depositors such as corporate depositors. The Directive nevertheless leaves Member States free to adopt a general deposit preference under their national laws. [19]

B. - Key Impacts

3 - The new ranking will allow EU G-SIBs to issue instruments with a lower cost than regulatory capital which still count towards their *minimum TLAC requirements*. [20] Senior non-preferred instruments will also allow institutions to meet their *institution-specific MREL*, which applies to all EU institutions and not only G-SIBs (where competent authorities require MREL to be met with instruments that are subordinated to ordinary unsecured liabilities).Due to the fact that senior non-preferred instruments will rank senior to regulatory capital, they will be subject to bail-in *only if the institution is placed in resolution* and will *not be subject to mandatory write-down and conversion at the point of non-viability under Article 59 of BRRD* (which applies to regulatory capital instruments only).

The new rank ensures that claims resulting from ordinary commercial relationships with the banks (e.g. operational liabilities and deposits, including non-retail) are subject to a lower risk of bail-in than bonds, which are subscribed on the basis of a deliberate investment decision.

The Directive should not affect the rank in insolvency of existing senior instruments, which should continue to rank senior to senior non-preferred instruments. [21]

The Directive reduces the disparity between national bank insolvency regimes, which had created uncertainty for investors and potential difficulties when applying resolution tools in a cross-border context. However, it does not fully eliminate such disparities since Member States remain entitled to create several classes within senior liabilities (as well as a general or tiered depositor preference, as mentioned above). [22]

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12. *See* ECON draft report dated September 8, 2017, Amendments Nos. 49, 51, 71 and 72. Article 45b(2) BRRD, as proposed by the EU Commission, provides that « [b]y way of derogation from point (l) of Article 72a(2) of Regulation (EU) No 575/2013, liabilities that arise from debt instruments with derivative features, such as structured notes, shall be included in the amount of own funds and eligible liabilities only where all of the following conditions are met : (a) a given amount of the liability arising from the debt instrument is known in advance at the time of issuance, is fixed and not affected by a derivative feature ; (b) the debt instrument, including its derivative feature, is not subject to any netting agreement and its valuation is not subject to Article 49(3) ; The liabilities referred to in the first subparagraph shall only be included in the amount of own funds and eligible liabilities for the part that corresponds with the amount referred to in point (a) of the first subparagraph. »
13. In line with a recommendation by the ECB (*see* ECB March 8, 2017 opinion, *cit.*, Para. 2.1.3), the Directive provides for a « grandfathering regime » taking into account national laws of Member States adopted prior to the entry into force of the Directive. In particular, Member States having adopted prior to 31 December 2016 a national law whereby ordinary unsecured claims resulting from debt instruments are split into two or more different priority rankings, or whereby the priority ranking of ordinary unsecured claims resulting from such debt instruments is changed in relation to all other ordinary unsecured claims of the same ranking, may provide that debt instruments with the lowest priority ranking among those ordinary unsecured claims qualify as senior non-preferred.
14. *See* ECON draft report dated September 8, 2017, Amendments Nos.53 and 85.
15. *See* ECON draft report dated September 8, 2017, Amendments Nos. 46 and 77.
16. *See* ESMA, Guidelines on complex debt instruments and structured deposits, February 4, 2016 (available at *www.esma.europa.eu/sites/default/files/library/2015-1787_-_guidelines_on_complex_debt_instruments_and_structured_deposits.pdf*), p. 9.
See also the EU Economic and Social Committee opinion on the « 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, » adopted on February 2, 2017 (available at *http://eur-lex.europa.eu/legal-content/EN/TXT/ ?uri=CELEX :52017AE0002*), Para. 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 in this area to be fully applicable and that it can be given full effect in practice. »
17. *See* ECON draft report dated September 8, 2017, Amendments 57 and 79.
18. *See* ECB March 8, 2017 opinion, *cit.*, Paras. 2.3.1 and 2.3.2 (« ECB sees merit in the introduction of a general depositor preference, based on a tiered approach, in the Union... 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 »).
19. *See* Recital 16 of the Directive : « This Directive is therefore without prejudice to any existing or future national laws of Member States governing normal insolvency proceedings that cover the insolvency ranking of deposits, to the extent that such ranking is not harmonised by [BRRD], irrespective of the date on which the deposits were made ».
20. See above in relation to the proposal to extend the senior non-preferred rank to debt instruments with derivative features such as structured notes.
21. See Article 4 of the Directive : « Member States shall ensure that their national laws governing normal insolvency proceedings as they were adopted at 31 December 2016 apply to the ranking in normal insolvency proceedings of unsecured claims resulting from debt instruments issued [...] prior to the date of entry into force of measures under national law transposing [the Directive]. »
22. *See* Recital 10 of the Directive : « Member States should be allowed to create several classes for other ordinary unsecured liabilities provided that they ensure, without prejudice to other options and exemptions provided for in the TLAC standard, that only the non-preferred senior class of debt instruments is eligible to meet the subordination requirement. ». Conversely, the EU Economic and Social Committee had expressed the view that « it is not

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3. Impact on selected national regimes

4 - In order to facilitate resolution of large banks in their jurisdictions and avoid the persistence of taxpayer funded bail-outs, certain Member States had begun to reform their national insolvency laws to introduce a subordination requirement prior to the publication of the Commission's November 2016 proposals, with diverging approaches.

A. - France

5 - In France, the « Sapin 2 » law, enacted on 9 December 2016, modifies the hierarchy of creditor claims in bank insolvency in line with the Directive (which was modeled on the French approach, initially proposed in March 2016).

Specifically, Article L.613-30-3-I-4 of the French Monetary and Financial Code creates a senior non-preferred rank for liabilities that have the following characteristics :

- they are unsecured claims arising out of debt instruments (i.e. bonds and other forms of transferable debt whether issued under French or foreign law, as well as *bons de caisse* or similar instruments issued under the laws of a Member State that have not been offered to the public) ;
- the contractual documentation expressly refers to this ranking ;
- their initial contractual maturity is at least one year ;
- they have no « structured » features.

Senior non-preferred instruments will rank senior to regulatory capital and subordinated debt ; but junior to ordinary unsecured liabilities (including standard senior liabilities, short term debt instruments, operational liabilities, derivatives and deposits). The new rank applies to newly issued instruments only. Existing senior instruments will be automatically rank senior to newly-issued senior non-preferred instruments.

Given the close alignment with the Directive, it is not expected that French law will need to be significantly amended to implement the Directive. However, a decree implementing the notion of « structured » features has yet to be adopted. It should also be noted that French law has introduced the senior non-preferred rank only with respect to credit institutions, while the Directive requires it to be introduced with respect to credit institutions as well as investment firms, financial holding companies and financial institutions within their consolidation perimeter.

B. - Germany

6 - In Germany, the Resolution Mechanism Act (*Abwicklungsmechanismusgesetz*) was enacted in late 2015. [23] Among other things, the German Resolution Mechanism Act changed the ranking in insolvency of certain senior unsecured debt instruments issued by German CRR institutions (*i.e.*, CRR credit institutions and CRR investment firms) such as, among other things, bearer bonds and registered bonds (the « Relevant Debt Instruments »).

According to sections 46f(5) through (8) of the German Banking Act (*Kreditwesengesetz*), as introduced by the German Resolution Mechanism Act, in an insolvency scenario, any senior unsecured debt other than Relevant Debt Instruments is to be discharged first. Consequently, any other senior unsecured debt is granted priority over the Relevant Debt Instruments, and Relevant Debt Instruments rank junior to such other senior unsecured debt. Relevant Debt Instruments, however, continue to rank senior to any debt that is otherwise statutorily or contractually subordinated. The change in ranking does not apply to debt obligations which are exempt from bail-in pursuant to the German rules implementing article 44(2) BRRD such as, *inter alia*, covered deposits and obligations vis-à-vis bank employees, as well as money market instruments and structured products such as derivatives. [24]

The provision whereby senior unsecured debt is granted priority over Relevant Debt Instruments applies since January 1, 2017. It applies not only to Relevant Debt Instruments issued after such date, but also *any and all Relevant Debt Instruments outstanding on such date*.

The main reason for the change in ranking of Relevant Debt Instruments was to facilitate the application of the bail-in tool by creating a class of eligible liabilities that can be easily and quickly determined because such liabilities are neither complex nor related to critical functions or core business lines. Also, it was expected that the change in ranking of Relevant Debt Instruments should facilitate their TLAC-eligibility without the need, or reducing the need, for German G-SIBs to issue new (subordinated) debt, because Relevant Debt Instruments, after January 1, 2017, would rank junior to operational liabilities.

Although the Directive, according to restated article 108(4) BRRD, will not apply to debt instruments issued prior to the date of implementation of the Directive into national law, the Directive will require certain changes in German law to the insolvency ranking of bank debt as described above. Pursuant to the German Resolution Mechanism Act, Relevant Debt Instruments (whether issued before or after January 1, 2017) by operation of law rank junior to *all* other senior unsecured debt. The Directive, however, provides the issuing banks with flexibility to issue debt instruments ranking *equal* to other senior unsecured debt (including debt instruments that would currently constitute Relevant Debt Instruments) or ranking *junior* to such debt, but senior to subordinated debt. Hence, the German legislature would have to introduce the option for banks to issue debt instruments ranking in insolvency in line with the Directive (*e.g.*, by adjusting the features of Relevant Debt Instruments to the Directive), and thereby grant German banks the option to also issue debt securities that rank equal to the bank's other senior unsecured debt. In such context, the German legislature would also need to decide where debt instruments issued after the date of application of the Directive and complying therewith would rank in relation to Relevant Debt Instruments issued prior to such date.

C. - Italy

7 - The Italian implementation of the BRRD generally mirrors the text of that directive. [25] However, with respect to the imple-

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. 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. » *See* the EU Economic and Social Committee opinion adopted on February 22, 2017, *cit.*, Paras. 3.8 and 3.9

23. *www.bundesfinanzministerium.de/Content/DE/Downloads/Gesetze/2015-11-05-Abwicklungsmechanismusgesetz.pdf ;jsessionid=C82462A6AC0CE238ECD5D95E49A55378 ?__blob=publicationFile&v=3*

24. For details on this exemption for structured products, see our alert memorandum « BaFin and FMSA Issue Guidance on Ranking on Bank Bonds in Insolvency » of August 9, 2016 : *www.clearygottlieb.com/news-and-insights/publication-listing/bafin-and-fmsa-issue-guidance-on-ranking-of-bank-bonds-in-insolvency*

25. Italy implemented the BRRD through two Legislative Decrees : While the first decree (No.180 of 2015 ; « Resolution Decree ») has implemented mostly

mentation of Article 108 BRRD, it went one step further by extending the depositor preference beyond what was required by the BRRD.

Indeed, the Italian rules modify the creditors' hierarchy in bank insolvency (*liquidazione coatta amministrativa*) and resolution proceedings commenced after January 1, 2019, [26] making « other deposits » (*i.e.*, deposits that are not granted priority treatment under Article 108 BRRD) senior to other unsecured debt of the bank but junior to deposits granted priority treatment under Article 108 BRRD (i.e. covered deposits and deposits from natural persons and micro, small and medium-sized enterprises). [27]

However, this depositor preference does not fully achieve the TLAC/MREL objective of facilitating the bail-in of senior unsecured debt instruments. Indeed, while subordinated to deposits, senior unsecured debt instruments would still rank *pari passu* with operational liabilities or liabilities arising from derivatives or structured notes. Italy therefore needed to amend its rules on creditor hierarchy in order to implement the Directive. [28]

By Law No. 205 dated December 27, 2017 (« 2018 Budgetary Law »), Italy has introduced a new category of non-preferred senior debt (« *strumenti di debito chirografario di secondo livello* »), which ranks junior to all other unsecured claims (including operational liabilities and liabilities arising from derivatives or structured notes), but senior to subordinated liabilities in a bank insolvency (*liquidazione coatta amministrativa*) – and therefore, in resolution. [29] These new non-preferred senior debt instruments will have a unitary notional value of at least Euro 250,000 and – in line with some amendments that had been proposed by ECON – may only be sold to qualified investors. [30]

Due to the fact that the Directive allows Member States to create a tiered depositor preference, [31] it does not require Italy to change its rules on depositor preference. The 2018 Budgetary Law did not amend those rules.

As a result, the ranking of senior liabilities (other than senior non-preferred instruments) *vis-à-vis* deposits in an insolvency or resolution scenario will depend on when the proceedings are initiated :

- in insolvency or resolution proceedings initiated prior to January 1, 2019, these senior liabilities will rank *pari passu* with « other deposits » ;
- in insolvency or resolution proceedings initiated after January 1, 2019, these senior liabilities will rank junior to « other deposits ». ∎

Mots-Clés : Bank Creditor hierarchy - EU

the BRRD provisions on resolution, the second decree (No. 181 of 2015 ; « Amending Decree » and together with the Resolution Decree, « Decrees ») amended relevant provisions of the Italian Banking Act (Legislative Decree No. 385 of 1 September 1993 or « TUB ») and the Italian Securities Market Law (Legislative Decree No. 58 of 24 February 1998 or « TUF »).

26. *See* Article 1(33) of Amending Decree amending Article 91 of the TUB and Article 3(9) of the Amending Decree.
27. *See* Article 91(1-*bis*) of the TUB as amended by the Amending Decree.
28. The Explanatory Memorandum accompanying the Commission's November 2016 proposal mentions that the Commission considered to provide for a « statutory preference for all deposits vis-à-vis senior debt » but opted for the « creation of a specific 'unpreferred' senior class for unsecured debt » as « the most cost effective way » to ensure compliance with TLAC and MREL requirements.
29. *See* Article 1, Paras. 1103 and ff. of the 2018 Budgetary Law, which introduced a new Article 12-*bis* TUB and a new let. c-*bis* to Para. 1-*bis* TUB. In addition to banks, certain investment firms (*SIM*) are allowed to issue these new non-preferred senior debt. *See* Article 1, Para. 1104 of the 2018 Budgetary Law, introducing a new Article 60-*bis*.4-*bis* TUF.
30. *See* Article 1, Para. 1105 of the 2018 Budgetary Law.
31. *See* Recital 16 of the Directive.