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Briefing note

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Spain creates the senior non-preferred debt

Spain has created the new category of senior non-preferred debt by means of Royal Decree-law 11/2017, of 23 June, on urgent measures in financial matters ("**RDL 11/2017**"). As from 25 June 2017, the date on which RDL 11/2017 entered into force, and in the event of the insolvency of credit entities and investment service companies ("**entities**"), ordinary claims will be classified as either 'preferred' ordinary claims or 'non-preferred' ordinary claims, the latter having a lower ranking than the former. An ordinary claim will only be considered 'non-preferred' if it meets all of the conditions established for such purposes under RDL 11/2017.

Key Issues

- Spain has created the new category of senior non-preferred debt.
- In case of insolvency (*concurso*) of credit entities and investment services companies, ordinary claims will be classified into preferred ordinary claims and non-preferred ordinary claims, the latter having a lower ranking than the former.
- An ordinary claim will only be considered as non-preferred if it meets all conditions under RDL 11/2017.
- The possibility for Spanish entities to issue senior debt instruments which meet the subordination requirement is now expressly acknowledged in the law.

Background

One of the key objectives of Directive 2014/59/EU of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms ("**BRRD**") (and therefore of Law 11/2015, of 18 June, and Royal Decree 1012/2015, of 6 November, which implement the BRRD in Spain) is to facilitate private sector loss absorbency in the event of a bank crisis. To achieve this objective, all banks are required to meet a Minimum Requirement for Own Funds and Eligible Liabilities ("**MREL**") to ensure that sufficient financial resources are available for write down or conversion into equity. Under the BRRD, there is no general requirement as to the mandatory subordination of eligible instruments for MREL. This means, in practical terms, that a liability eligible for MREL may rank in insolvency at the same level (pari passu) as certain other liabilities which are not bail-inable, or which are bail-inable but are excluded from bail-in by the resolution authority under exceptional circumstances. This could lead to situations where bailed-in bondholders may claim they have been treated worse under resolution than under a hypothetical insolvency. In such case, they would need to be compensated. To avoid this risk, it is currently being considered that resolution authorities may decide that the MREL requirement should be met with instruments that rank in insolvency below other liabilities that are either not bail-inable by law or are difficult to bail-in ("subordination requirement").

On 9 November 2015, the Financial Stability Board published the Total Loss-absorbing Capacity (TLAC)

Term Sheet (the "**TLAC standard**"), which requires global systemically important banks (G-SIBs), referred to as global systemically important institutions (G-SIIs) in European Union legislation, to hold a sufficient minimum amount of highly loss absorbing (bail-inable) liabilities (the "**TLAC minimum requirement**") to ensure the smooth and fast absorption of losses and recapitalisation in resolution. The TLAC standard establishes that liabilities may be eligible for TLAC only if they absorb losses in insolvency or in resolution prior to other 'preferred' liabilities that are explicitly excluded from TLAC eligibility, such as derivatives, covered deposits or tax liabilities. The TLAC standard provides, therefore, for a subordination requirement subject to certain exemptions, but it is not prescriptive as to the way to achieve it.

With the aim of incorporating the TLAC standard into EU law, on 23 November 2016, the European Commission approved, among others, the Proposal for a Directive of the European Parliament and of the Council amending the BRRD as regards the ranking of unsecured debt instrument in insolvency hierarchy (the "**Proposal**"). The Proposal envisages the creation of a new class of non-preferred senior debt that should only be bailed-in after own funds instruments and subordinated liabilities other than Additional Tier 1 and Tier 2 instruments, but before other senior liabilities. Entities should remain free to issue debt in both senior and 'non-preferred' senior classes while, of these two classes, only the 'non-preferred' senior class should be eligible to meet the subordination requirement for TLAC or MREL purposes.

RDL 11/2017

Spain has created the new class of non-preferred senior debt prior to the approval of the Proposal by making use of the possibility provided in said Proposal for Member States to adapt their national laws governing the ranking of unsecured debt instruments in insolvency proceedings, to the international standard, before the date of application of the Directive.

RDL 11/2017 amends the second paragraph of Additional Provision 14 of Law 11/2015 to include non-preferred ordinary claims, which will be those arising from debt instruments that meet the following conditions:

a) they have been issued or created with an effective term equal to or greater than a year;

b) they are not derivatives and have no embedded derivatives; and

c) the terms and conditions and, where applicable, the prospectus relating to the issue, include a clause establishing that they have a lower ranking vis-à-vis the remaining ordinary claims and, therefore, claims arising from these debt instruments will be paid after the remaining ordinary claims.

Non-preferred ordinary claims which meet the above conditions will rank behind the ordinary claims referred to in Article 89.3 of Spanish Law 22/2003, of 9 July, on Insolvency (the "**Insolvency Law**") and ahead of the subordinated claims included in Article 92 of the Insolvency Law, and will be paid before them.

With the creation of this new category, the possibility for Spanish entities to issue senior debt instruments which meet the subordination requirement (previously purely contractual) and are therefore eligible for MREL purposes and, where appropriate, for TLAC purposes is now expressly acknowledged in the law. However, RDL 11/2017 does not establish the other requirements with which such instruments will have to comply to be eligible liabilities. For such purposes, it will be necessary to take into account the current draft of Article 72b of the Proposal for a Regulation amending Regulation (EU) No 575/2013, commonly known as CRR2.

RDL 11/2017 also amends Article 217.3 of the Securities Market Law in order to treat bonds, notes and similar securities, which are eligible liabilities, as 'complex instruments' for the purposes of the conduct of business rules contained therein.

Like any decree-law, RDL 11/2017 has to be ratified by the Spanish Parliament within 30 days of its publication in the Official State Gazette. If not ratified within such period, RDL 11/2017 shall be deemed to be repealed.

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