

## POLAND CREATES SENIOR NON-PREFERRED DEBT

Poland has created a new category of senior non-preferred debt by the Act of 17 January 2019 (the "**Amendment Act**") amending, among others, the Act of 10 June 2016 on the Bank Guarantee Fund, Deposit Guarantee Scheme and Resolution (the "**BFG Act**"). As from the date on which the Amendment Act will come into force, in the event of the insolvency of a credit institution subject to the resolution scheme ("**institutions**"), ordinary claims will be classified as either senior "preferred" claims or senior "non-preferred" claims, the latter having a lower ranking than the former. An ordinary claim will only be considered as "non-preferred" if it meets all the conditions established for such purposes under the Amendment Act.

### BACKGROUND

On 12 December 2017, the Council of the European Union and the European Parliament adopted Directive (EU) 2017/2399 amending Directive 2014/59/EU of 15 May 2014 (the "BRRD") as regards the ranking of unsecured debt instruments in the insolvency hierarchy of credit institutions and investment firms (the "Directive"). The Directive introduces senior non-preferred debt instruments as a new asset class ranking between traditional bank senior debt and subordinated Tier 2 debt.

Senior non-preferred debt has been created mainly to improve the bail-in procedure by reducing the possibility of "no creditor worse off" claims<sup>1</sup>. The new class of instruments should only be bailed-in after own funds instruments and subordinated liabilities but before other senior liabilities. As long as the institutions remain free to issue debt in both classes, in case of insolvency the resolution authority can use senior non-preferred instruments as a priority when applying the bail-in mechanism without the obligation to use other senior instruments in the same proportion.

The new class of instruments has also been designed as a tool to help institutions meet requirements resulting from the application of the Minimum Requirement for Own Funds and Eligible Liabilities ("MREL") regulations.

### Key issues

- Poland has created a new category of senior non-preferred debt.
- In the case of the insolvency (upadłość) of credit institutions, senior non-preferred claims will rank behind other senior liabilities but ahead of subordinated debt in ordinary insolvency proceedings.
- A claim will only be considered as senior non-preferred debt if it meets all the conditions under the Amendment Act.
- The possibility for Polish credit institutions to issue senior non-preferred debt instruments will be expressly acknowledged by Polish law.
- The new instrument will help Polish credit institutions in meeting MREL requirements.

<sup>1</sup> i.e. situations where bailed-in bondholders may claim they have been treated worse under a resolution action than under a hypothetical insolvency in which case they would need to be compensated.

The Directive came into force on 28 December 2017 obliging Member States to adapt accordingly their national laws governing the ranking of unsecured debt instruments in insolvency proceedings.

## **POLISH AMENDMENT ACT**

The Amendment Act amends the Polish Insolvency Law of 28 February 2003, as amended (the "Insolvency Law") to include senior non-preferred ordinary claims, which will be those arising from debt instruments that meet the following criteria:

- have an initial contractual maturity of at least one year;
- are not derivatives and have no feature of a derivative;
- include a contractual provision specifically referring to its ranking; and
- have a denomination per unit of at least PLN 400.000 (or a foreign currency equivalent).

Non-preferred ordinary claims which meet those conditions will rank behind the ordinary claims referred to in Article 440 paragraph 2 point 5 of the Insolvency Law and ahead of the subordinated claims included in Article 440 paragraph 2 point 7 of the Insolvency Law (therefore will be repaid before any subordinated debt).

## **MREL METHODOLOGY**

The creation of the new debt category will allow Polish institutions to issue new debt instruments. However, the Amendment Act itself does not establish the requirements such instruments will have to comply with to meet MREL eligibility criteria. For this purpose, it is necessary to take into account:

- the BFG Act, which specifies the conditions the instrument must meet to be used for MREL calculation purposes; and
- the policy statement of the Bank Guarantee Fund (the "BFG") dated 26 November 2018 setting out the MREL methodology and presenting BFG's expectations on the MREL-eligible instruments (the "MREL Methodology Statement").

According to the BFG Act, the instrument may be used to meet the MREL ratio if:

- it has been issued and fully paid;
- it is not owned, guaranteed or otherwise secured by the issuing entity;
- its purchase has not been funded directly or indirectly by the issuing entity;
- it has an initial contractual maturity of at least one year;
- it is not a derivative and its value is not dependent on embedded derivatives; and
- it does not arise from a deposit which is higher ranked in the insolvency proceedings.

Additional criteria regarding MREL-eligible instruments are included in the MREL Methodology Statement. The BFG expects that the MREL will be met with subordinated instruments only which have a nominal value per unit of at least PLN 400.000 and are distributed to the qualified investors only.

When comparing these two regimes, it is apparent that the majority of requirements provided for the MREL-eligible instruments are covered by the senior non-preferred debt introduced by the Amendment Act. According to the MREL Methodology Statement, the BFG requires that MREL shall be met with subordinated instruments only. Nevertheless, it also highlights that its approach will be verified after the Amendment Act comes into force. Therefore, it is not unjustified to assume that the BFG will reconsider its position on MREL-eligible instruments and will include senior non-preferred debt into the category of MREL-eligible instruments.

## **MARKET IMPLICATIONS**

The introduction of the senior non-preferred debt is a desired development for the Polish market that catches up with the introduction of this debt category in other Member States. It provides institutions with a newly defined class of eligible liabilities instruments which may be used to meet MREL requirements. The creation of the new instrument is also crucial taking into account that Poland has not yet introduced AT1 instruments<sup>2</sup>, which under the EU MREL regime meet loss absorbency requirements and therefore may be used for MREL purposes. In the absence of AT1 instruments issued under Polish law, this is senior non-preferred debt, which alongside with the own funds and subordinated liabilities, may be used to absorb losses in resolution without triggering claims that such resolution action leaves the holders of senior debt worse off than they would have been in liquidation.

The possibility to issue such new instruments may also have a positive impact on institutions' funding sources and therefore contribute to their operational stability and better perception by other market participants. It also has a chance to become a desirable component of institutional investors' bond portfolio.

Taking into consideration the MREL calibration and structure of eligible instruments required by the BFG, we believe that institutions will embrace the opportunity offered by the new instrument and include senior non-preferred debt in their issuance plans for the next few years.

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<sup>2</sup> AT1 instruments, commonly referred to as contingent convertibles or CoCos, can be distinguished by their unique ability to either convert into an equity instrument or mandatory write-down of their principal value. These instruments are widely used for resolution purposes in other Member States including the UK, France or Germany. Its issuance under Polish law is still controversial due to the lack of clarity on the legal basis for creating of this type of instrument. For more information about CoCos, see: [https://www.cliffordchance.com/briefings/2016/08/issuance\\_of\\_hybriddebtinstrumentsandso-called.html](https://www.cliffordchance.com/briefings/2016/08/issuance_of_hybriddebtinstrumentsandso-called.html)

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