Statement of the EBA and ESMA on the treatment of retail holdings of debt financial instruments subject to the Bank Recovery and Resolution Directive

Executive summary


2. The distribution of debt financial instruments issued by institutions¹ to retail clients, including the practice of ‘self-placement’ – whereby institutions place the debt financial instruments that they themselves (or other group entities) have issued with their own client base – may raise significant consumer protection issues and affect the practical application of the resolution framework under the BRRD.

3. Overall, the resolution framework has introduced tools and powers which allow, where certain conditions are met, the management of bank crises in a more flexible and effective manner than national insolvency rules. Application of these tools and powers may in turn lead to a more reduced impact on the bank’s liabilities and on debt holders in the event of a bank crisis. Nonetheless, even in cases of resolution, particular care should be taken in the implementation of bail-in in the presence of retail customers, as holders of debt liabilities subject to loss sharing. At the same time, it has emerged that in too many cases the initial sale of banks’ debt liabilities to retail investors and disclosure practices has not been applied in line with consumer protection requirements, resulting in the emergence of a substantial number of mis-selling cases.

4. The issue of retail holders of debt financial instruments remains significant considering that, on the basis of the data analysis conducted by the EBA and ESMA for the purpose of this

¹ ‘Institution’ defined in accordance with Article 1(1) of the BRRD.
Statement, retail investors still hold an important part of EU debt securities issued by institutions, and high concentration of retail debt holdings is evident in some EU countries.

5. At the same time, it must be highlighted that, in cases of bail-in, the BRRD does not provide for a different treatment of eligible liabilities based on the nature of the holder. Resolution authorities are required to apply the bail-in tool according to the waterfall of liabilities established in the framework regardless of the nature of the holders of the debt. Therefore, debt held by retail investors is subject to loss in resolution together with that owned by holders of other pari passu liabilities.

6. On this basis, the two authorities believe it is appropriate that institutions and authorities consider the following:

Institutions:

(i) The BRRD introduces strict burden-sharing requirements for shareholders and creditors before public funds could be used in a bank failure. As a result, it is important that retail investors understand the risks inherent in their investments in debt liabilities issued by institutions. ESMA notes that, in accordance with MiFID\(^2\), institutions must provide existing clients who already hold such instruments subject to the BRRD with complete and updated information on the potential treatment of such investments in resolution or insolvency. ESMA urges institutions to convey the information on the effects of the BRRD on retail clients holdings through the means of a specific written communication.

(ii) On 3 January 2018, MiFID\(^3\) has entered into application. The Directive includes a number of new provisions aiming to strengthen investor protection, some of them being particularly relevant to the cases related to retail investors purchasing instruments eligible for bail-in. In order to ensure that products are distributed to clients with whom they are compatible, it is essential that the strengthened investor protection framework be properly implemented by institutions and enforced by authorities. Particularly relevant are the new MiFID II requirements on (i) product governance, (ii) sale of complex debt instruments and (iii) assessment of suitability, and ESMA’s supervisory convergence work on these topics (for example guidelines and Questions & Answers (Q&As)).

Market authorities and resolution authorities:

Where there is a material presence of retail investors, resolution and market authorities could find it beneficial to open a cooperative dialogue and share relevant information, considering the importance of the consumer protection aspect to this topic.

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\(^2\) Article 24 of Directive 2014/65/EU (MiFID II) and Articles 44, 46, 47 and 48 of Delegated Regulation (EU) 2017/565 (MiFID II Delegated Regulation).

\(^3\) As complemented by the Delegated Acts, such as, inter alia, the MiFID II European Commission Delegated Directive 2017/593 (MiFID II Delegated Directive) and the MiFID II European Commission Delegated Regulation 2017/565/EU (MiFID II Delegated Regulation).
Resolution authorities:

It is important to clarify from the outset that the presence of a large stock of retail holders does not in itself constitute an impediment to resolvability and does not per se justify an exemption under Article 44(3) of the BRRD or Article 18(3) of the Single Resolution Mechanism Regulation (SRMR).

(i) Where resolution authorities establish that there is a material presence of retail investors as holders of debt liabilities of an institution subject to resolution, they are encouraged to give attention to this element in their resolution planning.

(ii) Concretely, when preparing a resolution plan for an institution, the resolution authority must assess the resolvability of the bank and must identify whether or not there are situations that present an impediment to resolvability. In this context, the presence of retail holders may play a role. In particular, the resolution authority should assess – among other issues – whether or not bail-in can be credibly and feasibly applied in resolution. If the resolution authority assesses that this could not be the case because of the presence of a large stock of retail held liabilities, it could consider if there are the conditions for an exemption based on Article 44(3) of the BRRD or Article 18(3) of the SRMR, what would be the impact of the exemption on the loss absorption capacity and if such an exemption would reduce the amount of loss-absorbing liabilities to an extent that would render a resolution strategy not credible. Where the resolution authority concludes that there is such a risk, the EBA would encourage the resolution authority, in close cooperation with the institution and the supervisor, to address this impediment. Potential means to address this impediment are outlined in more detail below.

Scope of the Statement

7. The scope of the Statement captures institutions’ debt liabilities placed with retail investors (on both an advised and a non-advised basis, and including in the context of self-placement) and/or owned directly by retail investors (including through the service of portfolio management). Ownership of institutions’ shares by retail clients or indirect retail holdings of institutions’ debt liabilities through investment or pension funds are not part of the Statement, given the different nature and risk profile of these products, which would merit a separate examination.

8. Among the resolution tools, the bail-in tool has a direct impact on the debt liability owned by the retail debt holder, as it enables resolution authorities to write down, reduce or convert those liabilities of the institution. The focus of this Statement is therefore on the application

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4 The scope of the paper also includes debt issued by holding companies, where those are resolution entities and issuers of Minimum Requirement for own funds and eligible liabilities (MREL) eligible liabilities. Debt capital instruments (AT1 and T2) are also included.  
5 In this regard, it should be noted that the scope of the analysis excludes all indirect retail holdings (for example through funds, which in turn also invest in institutions’ debt liabilities).
of the bail-in tool, which could be used in isolation or in combination with other resolution tools (i.e. sale of business, bridge institution or asset separation tool) together with the implications for the minimum requirement for own funds and eligible liabilities (MREL), which is a key precondition for the effective application of the bail-in tool.

9. First, the Statement assesses the significance of retail investors as holders of debt issued by EU institutions. Subsequently, it analyses the treatment of retail debt holdings from a consumer protection and resolution perspective.

10. The Statement is complemented by two annexes: (i) Annex 1 summarises the results of a qualitative survey of measures taken at EU Member State level to address investor protection issues of retail debt liabilities; (iii) Annex 2, ‘Legislative context’, summarises the relevant legal provisions in the BRRD framework.

11. It is worth highlighting that the present Statement reflects the current legislative framework on resolution. In addition, the positions expressed in this Statement are in line with the proposal made by the Commission in the context of the November 2016 Banking Package. At the same time, given that the proposal is currently under negotiation with the co-legislators, some of the consideration contained in the following may need to be reassessed depending on the final outcome of the legislative procedure.

12. Finally, it should be noted that this Statement is consistent with views already expressed by ESMA in recent related work⁶, and is without prejudice to any future work that may be conducted in the context of MiFID II.

Assessment of the relevance of retail held debt

13. ESMA and the EBA have conducted a data analysis to assess the relevance of retail investors as holders of debt issued by EU institutions. This assessment has been largely based on data derived from the ECB securities database.

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⁶ See (i) ESMA Statement on MiFID practices for firms selling financial instruments subject to the BRRD resolution regime (Ref: ESMA/2016/902 – June 2016); and (ii) ESMA Statement on ‘Potential risks associated with investing in Contingent Convertible Instruments’ (Ref: ESMA/2014/944 – July 2014).
14. The ECB SHS Sector\(^7\) data used in the analysis are focused on the EU banks’\(^8\) debt securities\(^9\) (senior unsecured debt and subordinated debt) as of Q3 2017 held by retail investors\(^10\) within the euro area.

15. There are significant limitations to these data. From an EU perspective, the most significant limitation is that the data on holdings by households are collected mainly from euro area custodians. The data exclude therefore holdings by euro area residents in custody outside the euro area and rely on the identification of households by custodians among their clients. Available data are expected to cover a large proportion of the euro area households’ holdings of senior and subordinated debt securities, but the data cannot be regarded as complete.

16. Because the data used do not capture bank debt held by non-euro area investors, they do underestimate the total retail exposure to EU bank debt. In particular, for non-euro area countries, the investments in EU bank debt by domestic retail investors are not included. Therefore, the coverage of holdings of securities issued by non-euro area countries is very partial, as it excludes domestic holdings.

17. On the basis of the data available for the euro area, the analysis confirms that retail investors still hold an important share of EU debt securities issued by European banks. As of Q3 2017, retail investors of the euro area held EUR 262.4 billion or 12.7% of the EU bank debt securities issued to euro area investors. Senior unsecured debt constituted 81% (or EUR 212.4 billion) of retail held debt securities, with the balance (19% or EUR 50.0 billion) represented by subordinated debt.

**Figure 1. EU bank senior and subordinated debt placed with euro area holders – proportion owned by retail holders (euro area only)**
(as of Q3 2017)

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\(^7\) The holdings data have been extracted from the Sector module (SHS Sector). The collected data include some holdings by associations and other similar bodies serving households. The framework for the collection of Securities Holdings Statistics is laid down in Regulation ECB/2012/24, amended by Regulation ECB/2015/18, Regulation ECB/2016/22 and Regulation ECB/2018/7. The Regulation as amended is complemented by Guideline ECB/2013/07, amended by Guideline ECB/2015/19, Guideline ECB/2016/23 and Guideline ECB/2018/8, which sets out the procedures to be followed by NCBs when reporting the data to the ECB (see [http://www.ecb.europa.eu/ecb/legal/1005/shs/html/index.en.html](http://www.ecb.europa.eu/ecb/legal/1005/shs/html/index.en.html)).

\(^8\) Deposit-taking corporations except central banks (S.122). Issuer countries are euro area and non-euro area EU Member States.

\(^9\) Debt securities issued by deposit-taking corporations, except the central bank (S.122). All positions are reported at market value.

\(^10\) Households (S.1M). The ‘holding by households’ aggregate of the ECB database, although comparable, is not fully consistent with the MiFID category of ‘retail clients’.
Figure 2. EU banks’ debt securities held by (euro area only) retail investors (by country of issuance\textsuperscript{11})
(as of Q3 2017)

\* The data cover mainly euro area investors. The coverage of holdings of securities issued by non-euro area countries excludes domestic holdings.

Sources: ECB SHS and EBA calculations

\textsuperscript{11} Because of limited data on certain breakdown items, information for Croatia, Luxembourg, Malta, Portugal and Finland is aggregated to ensure that information is unattributable.
18. By nominal amounts, high concentration is evident in some specific countries. As of Q3 2017, retail held debt issuance appears more significant in banks in a few countries: Italy has the largest amount (EUR 132.3 billion), followed by Germany (EUR 49.4 billion) and then France (EUR 31.7 billion). The distribution of retail debt is very fragmented, with much smaller nominal amounts reported after the first five countries (i.e. Italy, Germany, France, Austria and the UK).

19. Measured as a proportion of banks’ total12 debt (36.9%) and as a proportion of total banking sector assets (3.4%), banks in Italy have the largest proportion of euro area retail holders. Retail investors also constitute a significant part of banks’ senior and subordinated debt issuance (euro area investors only) in Austria (35.8%). This is despite banks in Austria ranking only in the fifth position in terms of nominal amount. For German banks, the ratio of retail held debt to total bank debt is lower, at 12.1%.

Figure 3. EU banks’ debt securities held by (euro area only) retail investors by country of issuance (in % of bank senior and subordinated debt and in % of total assets of the issuer country) (as of Q3 2017)

* The data cover mainly euro area investors. The coverage of holdings of securities issued by non-euro area countries excludes domestic holdings.

** Senior unsecured and subordinated debt issued to euro area countries.

Sources: ECB SHS and EBA calculations

MATURITY PROFILE OF RETAIL HELD BANK DEBT

12 Senior unsecured and subordinated debt issued to euro area investors by banks in the county of issuance (in this case in Italy).
The analysis of the maturity profile of the existing stock of retail held bank debt shows that, even assuming no new issuance to retail investors, retail owned debt will continue to be present for some time. Based on debt residual maturity, assuming no new issuances of bank debt to retail investors, until the end of Q3 2020, euro area retail investors’ holdings would still hold 38% of the senior unsecured debt and 68% of the subordinated bank debt they currently own. By the end of Q3 2022, the stock of retail held banks’ debt would have reduced to around a fifth of the current stock of senior unsecured debt and half of the subordinated debt, decreasing to EUR 39.2 billion and EUR 24.9 billion respectively.

Figure 8. EU banks’ debt securities held by (Euro area only) retail investors – amortisation profile (left, remaining stock in %; right, by nominal amount) (assuming no new issuances to retail investors)

Sources: ECB SHS and EBA calculations

Relevant aspects of consumer protection for the issue of retail investors in resolution
21. Evidence suggests that the issue of treatment of retail holders in resolution is closely interlinked with aspects of consumer protection.

22. It is important to note that the provision of investment services, including the sale of financial instruments to retail clients, was, until very recently, regulated by the MiFID I framework, which had been in application since 2007. On 3 January 2018, the MiFID I regime was replaced by MiFID II, which is having a major impact on the financial sector in Europe and includes a number of new provisions aiming to strengthen investor protection, some of them being particularly relevant to cases related to retail investors purchasing debt instruments that are eligible for bail-in. As the new regime has only recently entered into application, it is not yet possible to measure its effect on the distribution of liabilities subject to the BRRD resolution regime.

23. The two sections below set out important details on the consumer protection requirements that are relevant to current (‘legacy stock’) and future issuances of retail debt liabilities, given that they are subject to MiFID I and II requirements respectively. In particular:

a. Section A – Interim mitigation approach to address the legacy stock – sets out how the existing MiFID II disclosure requirements should be applied by institutions to existing investors in order to mitigate the impact on retail investors of an institution’s failure; and

b. Section B – Relevant MiFID II provisions for new issuances – sets out what the relevant MiFID II requirements are when selling or advising on the sale of financial instruments, including those subject to the resolution regime or providing portfolio management (in relation to the same instruments). This section also outlines relevant considerations on how MiFID II will help establish a higher level of protection for investors by ensuring that products are distributed to clients with whom they are compatible.

A – Interim mitigation approach to address the legacy stock

Information to be provided to existing investors

24. Because the resolution regime is relatively new, investors, and particularly less sophisticated ones, may not be familiar with its content and implications. Most importantly, the analysis of some investors’ complaints has shown that, in some cases, investors have been proactively approached by credit institutions and were wrongly given the impression that a recommended product was as safe as a deposit or was protected by a deposit guarantee scheme, neither of which was true.

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13 Directive 2014/65/EU as complemented by the Delegated Acts, such as, inter alia, the MiFID II European Commission Delegated Directive 2017/593 (MiFID II Delegated Directive) and the MiFID II European Commission Delegated Regulation 2017/565/EU (MiFID II Delegated Regulation).

14 ESMA, however, in its technical advice to the Commission on the MiFID II Level 2 measures, and its development of supervisory convergence work (for example guidelines and Q&As), has given high priority to the issue of mis-selling of financial instruments to retail clients.
25. According to Article 46(4) of the MiFID II Delegated Regulation, institutions should properly inform clients, in good time, of any material changes to the information provided on their investments in financial instruments, including if any material changes occurred to the situation of the issuer or to the features/conditions of the instruments. This provision also applies to, and may be particularly relevant to, investments in financial instruments that have become subject to the resolution regime that entered into force after the product was originally sold.

26. In order to explain the implications for investors of the new resolution framework – in line with the 2016 ESMA Statement15 – it is important that this information be provided to institutions’ existing clients who already hold relevant financial instruments (including through portfolio management services provided by the institution). Institutions’ clients should receive complete and updated information on the potential treatment of such investments in resolution or insolvency, including16 that:

- the instruments they hold are unsecured and therefore subject to the resolution regime or normal insolvency if the institution fails;

- the impact of an institution’s failure on investors depends crucially on the ranking of the liability in the insolvency creditor hierarchy (which may have changed because of the introduction of depositor preference), on the amount of losses incurred and on the resolution strategy applied;

- in the event of resolution:
  - the outstanding amount may be reduced to zero or the security may be converted into ordinary shares or other instruments of ownership for the purpose of stabilisation and loss absorption;
  - a transfer of assets to a bridge bank or in a sale of business may limit the capacity of the institution to meet repayment obligations, or may result in partial losses or no losses if the relevant liabilities are also transferred;
  - the maturity of instruments or the interest rate under these instruments can be altered and the payments may be suspended for a certain period;

- the liquidity of the secondary market in any unsecured debt instruments may be sensitive to events in financial markets;

- existing liquidity arrangements (for example repurchase agreements by the issuing institution) might not protect clients from having to sell these instruments at a substantial

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15 ESMA Statement on MiFID practices for firms selling financial instruments subject to the BRRD resolution regime (Ref: ESMA/2016/902).

16 See paragraph 15 of the ESMA Statement.
discount below their principal amount, in the event of financial distress of the issuing institution;

- liability holders have a right to compensation if the treatment they receive in resolution is less favourable than the treatment they would have received under normal insolvency proceedings (as a consequence of the application of the NCWO principle). This assessment must be based on an independent valuation of the institution. Compensation payments, if any, may be considerably later than contractual payment dates (in the same way that there may be a delay in recovering value in the event of an insolvency), although resolution, in principle, preserves value compared with insolvency.

27. Considering that financial instruments are often offered by the same institutions issuing them, or by entities having close links or any other legal or economic relationships with the issuer, it is normally expected that the relevant disclosure to these clients will be provided by the entity that has distributed the product to the client.

28. That said, institutions should identify the appropriate way to convey the information relevant to investments in financial instruments and the actual content of the communication provided. In particular, investors already holding financial instruments subject to the resolution regime (including through portfolio management services provided by an institution) could receive the above information through periodic reporting or through a specific ad hoc communication. The information above should be provided in a durable medium\(^\text{17}\), but institutions could also provide this information through their website or other electronic media provided that these means of communication fulfil the following conditions\(^\text{18}\):

- the provision of that information in that medium is appropriate to the context in which the business between the institution and the client is, or is to be, carried on;

- the client must specifically consent to the provision of that information in that form;

- the client must be notified electronically of the address of the website, and the place on the website where the information may be accessed;

- the information must be up to date;

- the information must be accessible continuously by means of that website for such period of time as the client may reasonably need to inspect it.

However, institutions should be encouraged to provide specific written communication that specifically emphasises to the client the information set out in paragraph 26 above.

**B – Relevant MiFID II provisions for new issuances**

\(^\text{17}\) See Articles 3 and 46 of the MiFID II Delegated Regulation.

\(^\text{18}\) See, inter alia, Article 24 of MiFID II and Articles 44, 46, 47 and 48 of the MiFID II Delegated Regulation.
Disclosure

29. Clients or potential clients investing in financial instruments, including those subject to the resolution regime, should\(^\text{19}\) receive accurate disclosure, at the point of sale, in good time and in any case before clients are bound by any agreement, including on the points set out in paragraph 26 above.

Distribution and self-placement

30. MiFID II contains provisions\(^\text{20}\) in respect of the conflicts of interest that arise when institutions sell proprietary financial instruments – such as common equity shares, preference shares, hybrid securities and debt – to their existing clients (‘self-placement’).

31. Institutions are required to identify any conflicts of interest potentially arising with their clients (or between clients) and to maintain and operate effective organisational and administrative arrangements to prevent such conflicts from adversely affecting the interests of their clients.

32. In the case of distribution of financial instruments subject to the resolution regime issued by an institution or by other group entities, there is a heightened risk that the interests of an institution may come into conflict with the best interests of its clients. It is therefore important for institutions to ensure that any targeting of financial instruments subject to the resolution regime to their clients does not compromise the overarching obligation to act honestly, fairly and professionally in accordance with the best interests of these clients, but duly takes their interests into account.

33. Institutions should also have in place internal arrangements that ensure that the pricing of the financial instruments subject to the resolution regime does not promote the institutions’ interests in ways that conflict with the client’s interests. These arrangements (such as the validation of the pricing via book building or an independent expert) become more important for those banks that are using self-placement as a channel to distribute their own instruments and for illiquid or non-standardised products where the pricing is difficult to assess because of the absence of commonly used benchmarks or of similar liquid products.

34. Furthermore, Article 41 of the MiFID II Delegated Regulation requires that institutions ‘which offer financial instruments issued by themselves or other group entities to their clients and that are included in the calculation of prudential requirements specified in [CRR], [CRD] or [BRRD], shall provide those clients with additional information explaining the differences between the financial instrument and bank deposits in terms of yield, risk, liquidity and any protection provided in accordance with [the Deposit Guarantee Schemes Directive].’

Sale of complex debt instruments

\(^{19}\) See Article 24 of MiFID II and Articles 44, 46 and 48 of the MiFID II Delegated Regulation (2017/565).

\(^{20}\) See Articles 16 and 23 of MiFID II and Articles 33 to 43 of the MiFID II Delegated Regulation.
One of the objectives of the review of MiFID was to strengthen the protection of investors in a context of increasing complexity of investment products and continuous innovation in their design. In line with the previous MiFID framework, Article 25(4) of MiFID II allows institutions to provide order-handling services without performing the appropriateness test or the suitability test (so-called ‘execution-only regime’). In addition to other conditions, the legislation requires that such services relate to ‘non-complex financial instruments’ (as well as ‘non-complex structured deposits’). MiFID II narrows the list of non-complex instruments by introducing (among others) the concept of instruments whose structure makes it difficult for the client to understand the risk attached, and it mandated ESMA to adopt Guidelines on (inter alia) the definition of such instruments. In its Guidelines, ESMA explained that liabilities that can be used for loss absorption purposes incorporate a structure that makes it difficult for the client to understand the risk attached and should be deemed ‘complex’\textsuperscript{21}. Therefore, the ESMA Guidelines clarify that all bail-inable debt instruments should not be sold within the execution-only regime.

**Provision of advice**

36. The provision of investment advice is specifically regulated under MiFID\textsuperscript{22}. The definition of investment advice includes the provision of personal recommendations to clients (either upon request or at the initiative of the institution) in relation to transactions relating to financial instruments. Specific protections for investors are laid down when investment advice is provided. In particular, it is established that institutions providing investment advice or portfolio management need to obtain the necessary information regarding the client’s or potential client’s knowledge and experience in the investment field relevant to the specific type of product or service, their financial situation and their investment objectives, to enable the institution to recommend to the clients or potential clients the investment services and financial instruments that are suitable for them as part of the assessment of suitability.

37. In self-placement situations, it is extremely likely that the interaction between the investor and the institution will involve personal recommendations (i.e. investment advice) being provided to clients. In these cases, a thorough assessment of the suitability of the financial instrument for the client must be conducted in accordance with the MiFID requirements.

**Assessment of suitability**

38. Under the MiFID II framework, institutions have to understand the characteristics, nature and features (including costs and risks) of investment products in order to allow them to recommend suitable investments (both in case of independent and non-independent advice), or invest in suitable products on behalf of their clients. Institutions should also assess, while taking into account cost and complexity, whether or not equivalent investment services or financial instruments can meet their client’s profile (see Article 54(9) of the MiFID II Delegated Regulation) and shall not recommend or decide to trade where none of the services or

\textsuperscript{21} ESMA Final Report on guidelines on complex debt instruments and structured deposits (ESMA/2015/1783), p. 20.

\textsuperscript{22} See Article 24(4) of MiFID II and Articles 52 and 53 of the MiFID II Delegated Regulation.
instruments are suitable for the client (see Article 54(10) of the MiFID II Delegated Regulation). In its public consultation for the review of the 2012 Guidelines on certain aspects of the suitability assessment, ESMA has underlined that institutions should appropriately and individually consider the different characteristics and risk factors (such as credit risk, market risk and liquidity risk) of investment products and classify them correctly, also taking into consideration their specific characteristics and nature. In this context, ESMA considers that institutions should correctly assess how certain products could ‘react’ under certain circumstances (e.g. convertible bonds or other instruments subject to BRRD that may, for example, be converted into shares).

39. More concretely, ESMA notes that, when selling (including self-placing) or advising investments in bail-inable liabilities, institutions should ask clients to provide information about their portfolio as a whole in order to ensure that an appropriate degree of diversification is achieved. In this context, institutions should be especially prudent regarding credit risk: exposure of the client’s portfolio to one single issuer or to issuers that are part of the same group should be considered an additional risk. This is because, if a client’s portfolio is concentrated in products issued by one single entity (or entities of the same group), in the event of default of that entity, the client may lose up to his or her entire investment. Therefore, when operating through so-called self-placement models, institutions should avoid an excessive concentration of investments in financial instruments subject to the resolution regime issued by the institution itself or by entities of the same group in the investor’s portfolio. ESMA believes that institutions should ensure that concentration with regard to credit risk is effectively identified, controlled and mitigated (for example, the identification of ex-ante thresholds could be considered).

40. ESMA furthermore notes that institutions advising a client on financial instruments that may bear losses in an insolvency or resolution or providing portfolio management should:

- consider the need to collect more in-depth information about the client than they would otherwise collect for similar instruments that are not subject to the resolution regime;

- ensure that institutions’ suitability assessment procedures adequately take into consideration the risk of the client’s losing money in insolvency or resolution (credit risk measures should be adjusted to reflect the fact that clients could lose money even without entry into insolvency or resolution);

- consider whether or not the risk associated with financial instruments used for meeting the resolution MREL requirement is consistent with the financial and risk profiles of the client and if the client will be able to bear the relevant losses in the event that the institution should fail;

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23 See ESMA/2012/387 and ESMA35-43-748.

24 As recalled by ESMA’s 2016 Statement on MiFID practices for firms selling financial instruments subject to the BRRD resolution regime.
• take proper account of the complexity of these instruments both in relation to the difficulty for investors to understand the risks attached to these instruments and in relation to the need to employ personnel with the skills, knowledge and expertise necessary for the discharge of the responsibilities allocated to them. To this effect, institutions should devote special attention to the training of sales staff responsible for relationships with clients, to make them familiar with the current BRRD resolution framework.

Product governance requirements

41. Article 16(3) and Article 24(2) of MiFID II introduced product governance obligations for manufacturers and distributors. These obligations were further specified in Articles 9 and 10 of the MiFID II Delegated Directive, with the objective of enhancing the level of protection of investors by way of requiring institutions to take responsibility, from the beginning, for ensuring that products and the related services are offered in the interest of clients. The objective of the product governance requirements is to ensure that institutions that manufacture and distribute financial instruments and structured deposits (from here on referred to as ‘investment products’) act in the clients’ best interests during all the stages of the life-cycle of products or services. In particular, under the new legal framework, institutions shall specify a target market of end clients for whose needs, characteristics and objectives the product is intended as well as a distribution strategy that is consistent with the identified target market. Recital (19) of the MiFID Delegated Directive notes that ‘the level of granularity of the target market and the criteria used to define the target market and determine the appropriate distribution strategy should be relevant for the product and should make it possible to assess which clients fall within the target market, for example to assist the ongoing reviews after the financial instrument is launched. For simpler, more common products, the target market could be identified with less detail while for more complicated products such as bail-inable instruments or less common products, the target market should be identified with more detail’ (emphasis added).

42. Furthermore, Article 9(10) of the MiFID II Delegated Directive requires manufacturers ‘to undertake a scenario analysis of their financial instruments which shall assess the risks of poor outcomes for end clients posed by the product and in which circumstances these outcomes may occur. Firms shall assess the financial instrument under negative conditions covering what would happen if, for example: (a) the market environment deteriorated; (b) the manufacturer or a third party involved in manufacturing and or functioning of the financial instrument experiences financial difficulties or other counterparty risk materialises’ (emphasis added).

43. ESMA has recently published Guidelines on MiFID II product governance requirements25 to give guidance to institutions and national competent authorities on how to apply the new requirements and ensure a harmonised and convergent implementation across all Member States.

25 ESMA35-43-620 (2 June 2017).
Treatment of retail holders of debt financial instruments in resolution

44. The investor protection framework plays an important role in determining the treatment of retail debt holders in resolution. This may be in particular because these customers are not necessarily sufficiently aware of the risks associated with certain financial products. A robust investor protection regime, properly implemented by institutions, may provide more clarity and transparency on the financial products purchased by retail customers and could ensure that retail customers invest carefully and appropriately in financial products. In turn, this may also have a positive impact on the ability of resolution authorities to bail in retail debt liabilities, as it may to an extent mitigate the risk of loss of confidence. In this respect, the further strengthening of the consumer protection framework illustrated above under MiFID II, if properly implemented and enforced, may represent, with respect to future new issuances, an important positive factor on the ability of resolution authorities to bail in retail debt liabilities.

45. Taking the above into account, where the presence of retail debt holders is relevant and material, a cooperative dialogue between resolution and market authorities could be particularly beneficial also in terms of sharing relevant information, including for example the assessment by the market supervisors of the degree of compliance of the institution with the MiFID requirements.

46. Even in the absence of mis-selling cases, the consequences of the application of bail-in to retail debt liabilities, in cases of significant exposures, could also present specific challenges from the perspective of contagion effects and financial instability. From a general perspective, bailing in retail holders may affect overall confidence in the financial markets. In certain cases, the loss of a certain financial investment may have a substantial impact on the economic situation of a retail client and his or her household. These elements, when occurring on a sufficiently large scale, may trigger severe reactions in retail customers, which could in turn possibly lead to bank runs.

47. The issue of the presence of retail debt holders in resolution becomes more acute in cases where the institutions place their debt securities directly with their own retail clients (self-placement). The fact that retail bondholders are also clients of the institution means that their bail-in would damage the customer base and reputation of the institution, which could in turn make it more challenging for resolution authorities to restore the franchise value and business viability of the institution after resolution.

48. Besides the measures devised in the context of the investor protection framework, there may also be a need to take the presence of retail holders into due consideration from the perspective of resolution planning, in the light of the tools provided by the resolution framework (BRRD/SRMR and related application measures).

Importance of proper consideration in resolution planning
49. Resolution authorities may devote attention to the potential impact of bailing in retail debt liabilities, when relevant and material, in their resolution planning. These liabilities may, under specific and exceptional circumstances, be exempted from bail-in. Effective resolution planning would allow resolution authorities to take these instances into account in advance, limit their adverse impact and choose the most appropriate resolution strategy.

50. If they had not properly assessed and addressed this issue in advance during the resolution planning phase, resolution authorities’ interventions could be adversely affected and this could constrain the type of resolution approach implemented. For example, without proper advanced planning, in the exceptional case of discretionary exclusion of those retail debt liabilities, resolution authorities could possibly face the risk that the available MREL and other bail-in liabilities would not be sufficient for the implementation of the resolution strategy.

51. Resolution authorities may not be in a position to identify who the holders of particular liabilities are, and for this reason it may not be possible for them to distinguish between types of holders within the same class. Where resolution authorities consider that this issue could be relevant in their jurisdiction, resolution authorities are encouraged to ensure that proper information on this aspect is readily available when establishing the type, characteristics and value of institutions’ liabilities in the context of resolution planning.

52. In the resolution planning phase, resolution authorities must assess the feasibility and credibility of their planned resolution strategy. In this context, the presence of retail holders may play a role. In particular, the resolution authority should assess – among other issues – whether or not, in the event of bail-in, an exemption based on Article 44(3) of the BRRD or Article 27(5) of the SRMR can be applied to the retail instruments.

53. An exemption would be justified, based on BRRD/SRMR provisions, if there are reasons to conclude that bailing in such liabilities would (i) not be possible within a reasonable timeframe, (ii) cause contagion, (iii) impair the continuity of the institution’s critical functions or (iv) cause a disproportionate destruction in value. All these circumstances have to be regarded as exceptional. Further guidance on how to assess the existence of one or more of these scenarios is provided by Commission Delegated Regulation 2016/860. \(^\text{26}\) The Delegated Regulation provides detailed indications of elements to be assessed to conclude that an exemption is justified. An example of one element that may be of particular importance when assessing a potential exemption for retail holdings is ‘the number of natural persons directly and indirectly affected by the bail-in, visibility and press coverage of the resolution action, insofar as that has a significant risk of undermining overall confidence in the banking or broader financial system’. \(^\text{27}\)

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\(^\text{26}\) Commission Delegated Regulation (EU) 2016/860 of 4 February 2016 specifying further the circumstances where exclusion from the application of write-down or conversion powers is necessary under Article 44(3) of Directive 2014/59/EU of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms.

\(^\text{27}\) Article 8(2)(b) of the Delegated Regulation.
54. In cases where the resolution authority reaches the conclusion that an exceptional ad hoc exemption based on Article 44(3) of the BRRD or Article 27(5) of the SRMR for retail debt held liabilities may, under certain circumstances, be justified for a certain bank, it should then assess the potential impact of the exemption on the institution’s loss absorption capacity. The resolution authority may in this case conclude that such an exemption would reduce the amount of loss-absorbing liabilities to an extent that would render a resolution strategy not credible. This would be the case, in particular, if, as a consequence of the exemption of retail holdings, the resolution authority was forced, in order to cover the expected losses for that institution, to resort to liabilities ranking more senior than or pari passu with the retail holdings and if that was expected to lead to a breach of the NCWO principle.

55. In this case, the resolution authority may reach the conclusion that bailing in those retail customers represents a barrier to the resolvability of the institution and start working to ensure that this barrier is removed ex ante and in a timely way.

56. In this context, resolution authorities, in accordance with Article 3(2) of Commission Delegated Regulation 2016/1450, shall ensure that MREL is sufficient for the purposes of loss absorption and recapitalisation. They could consider, on a case-by-case basis, options to achieve this.

Potential approaches to treating retail debt liabilities in resolution planning

57. In certain circumstances, it may be possible to achieve the objective of resolvability by requiring that MREL be met with additional issuance of MREL-eligible liabilities (i.e. liabilities that are not those held by retail holders) to the extent necessary to ensure that, in cases of exemption of retail held liabilities, the NCWO safeguard is respected. In this regard, Article 3(3) of Commission Delegated Regulation 2016/1450 requires the resolution authorities to assess the risk of the breach of the NCWO safeguard where mandatorily or discretionarily excluded liabilities comprise more than 10% of a given class of liabilities that includes liabilities that qualify for inclusion in MREL.

58. The requirement for additional issuance of other MREL-eligible instruments must be made by the resolution authorities only as a result of the case-by-case assessment carried out in the context of resolution planning along the lines of the process outlined above. In this respect, it is important to restate that the presence of a large stock of retail holders does not in itself constitute an impediment to resolvability and does not per se justify an exemption under BRRD/SRMR. It is for the resolution authority, on a case-by-case basis, to carefully assess if there is a risk that liabilities held by retail investors in that specific bank would be exempted, based on the criteria provided in the framework, and if this creates an impediment to the institution’s resolvability. It is important to restate in this respect that ad hoc exemptions under BRRD/SRMR are explicitly referred to as exceptional cases. In addition, such discretionary deviation from the principle of equal treatment of creditors of the same creditor class within the insolvency
hierarchy should be proportionate, justified by the public interest and not discriminatory\textsuperscript{28}, to avoid negatively affecting fundamental rights of other holders of the bank’s liabilities. Finally, moral hazard may become a concern when exceptional discretionary exclusions of retail debt liabilities from bail-in are applied in a predictable and potentially systematic manner in resolution. This could indeed be seen as an invitation to retail investors to invest in higher yield products on the assumption that they will be protected from the risk of bail-in should an institution ultimately fail.

59. Another approach would be requiring that an institution meets its MREL requirement with resources subordinated to those held by retail investors, with a view to limiting the risk that retail holders are bailed in (thereby excluding the need to consider their exemption). Issuance of subordinated instruments would provide an additional buffer of subordinated liabilities, which may help make the risk that retail debt holders would be bailed in more remote. These issuances in the future may include instruments that conform with the requirements of the recently agreed Directive amending the ranking of unsecured debt instruments in insolvency, which creates a new class of ‘non-preferred’ senior debt that should be bailed in in resolution only after other capital instruments and before other senior liabilities\textsuperscript{29}.

60. The two options highlighted above are not exhaustive, and resolution authorities could come up with additional or alternative measures as they see appropriate or even combine some elements of the different solutions. When assessing the possibility of these options, resolution authorities must carefully consider which one is deemed the more proportionate means to address the impediment to resolvability. This implies that the impediment should be addressed by requiring MREL to be met with non-subordinated and/or subordinated instruments in the manner that is the least costly to prevent NCWO breaches, based on the specific characteristics, business model and liability structure of the institution.

61. Treatment options in resolution planning of retail debt liabilities could influence the behaviour of institutions towards those liabilities. On the current stock of retail held debt liabilities, the treatment in resolution planning could provide an incentive for institutions to proactively reduce this stock through, for example, voluntary programmes of conversion of the retail debt liabilities into savings deposits with the ultimate objective of replacing debt liabilities with liabilities that could meet both resolvability and funding purposes.

62. However, certain important considerations must be made with respect to these options.

\textsuperscript{28} If resolution authorities intend to exclude from bail-in (on a mandatory or discretionary basis) more than 10% of the liabilities of a creditor class and such liabilities have ranking equal or junior to MREL resources, resolution authorities must make an assessment of whether losses can be absorbed by MREL resources without breaching the ‘no shareholder and creditor worse off’ safeguard (Article 3(3) of Commission Delegated Regulation (EU) 2016/1450 of 23 May 2016 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the criteria relating to the methodology for setting the minimum requirement for own funds and eligible liabilities, OJ L 237, 3.9.2016, p. 1-9, http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016R1450&from=EN).

63. Issuance of other MREL-eligible instruments, irrespective of whether they are subordinated or not, is effective only if such issuance does not eventually end up primarily with retail investors. However, nothing in the current legislation on financial services prevents retail customers from purchasing subordinated debt instruments or even shares in an institution. To address this concern, the resolution authority would have to revisit its decision on a periodic basis on the basis of updated information as regards the nature of holders of MREL instruments.

64. Issuing subordinated debt can be expensive and possibly not a practical solution depending on the type and business model of the bank. In general terms, the lower a liability ranks in bail-in, the riskier it is for the holder. The market should in principle be expected to price in this risk, which would increase the bank’s funding cost. In addition, not all banks have equal access to markets for subordinated debt, so their capacity to issue such instruments is rather limited. Additional issuances of such liabilities may therefore be unsuitable for certain types of banks.

65. Finally, even MREL subordination may expose resolution authorities to the risks of applying the bail-in tool to retail holders if they hold subordinated liabilities that rank pari passu with the other MREL subordinated liabilities. In addition, with this option, retail debt liabilities remain within the scope of the bail-in. As a result, depending on the extent of losses in resolution, retail debt holders, even in the senior class, could still be exposed to losses unless discretionarily excluded from the bail-in.

**Potential additional measure to address the treatment of retail debt holders**

66. Finally, from an investor protection and financial stability perspective, it is considered that a valid potential option to address the issue of retail holdings of debt instruments could be setting the requirement of a minimum issuance denomination (for example EUR 50 000 or EUR 100 000) in respect of certain debt instruments, which could be differentiated in consideration of their ranking in the insolvency creditor hierarchy as well as their complexity. This would increase the investment threshold, thereby limiting direct retail investment in riskier and more complex products. When considering the application of these measures, the specificities of the markets involved should also be taken into account.
Annexes

ANNEX I. DATA ANALYSIS – QUALITATIVE SURVEY OF MEASURES TAKEN AT COUNTRY LEVEL TO ADDRESS INVESTOR PROTECTION ISSUES OF RETAIL DEBT LIABILITIES

To complement the quantitative data analysis, the EBA and ESMA also conducted a qualitative survey to identify any own initiative measure taken by some national consumer authorities (NCAs) and/or institutions/banking associations in their country to address the investor protection issues arising from retail holdings of bail-inable bank debt. The following analysis is based on the responses to the qualitative questions received from the NCAs in Germany, Italy, the Netherlands, Austria and Portugal.

All respondents have taken measures to inform current investors about the implications of the BRRD. For the majority of respondents, this meant that they published the ‘ESMA Statement on MiFID practices for firms selling financial instruments subject to the BRRD resolution regime’ on their website and have therefore made investors aware of it. Some NCAs, however, have taken additional measures, which are discussed below.

Country-specific analysis

NCA measures

(i) Germany

The German Federal Financial Supervisory Authority (BaFin) introduced last year a three-step voluntary approach for informing clients about the implications of the BRRD. This method is voluntary but it has been followed by the majority of German banks, with the exception of cooperative banks. In accordance with this approach, (1) institutions inform their clients about the new regime in their annual accounts, (2) institutions advise clients to consult the BaFin website for detailed information on the bail-in mechanism and its implications and (3) institutions providing investment advice offer investors the opportunity to contact their advisor for further information.

30 Question 1: In the context of the BRRD, could you please indicate whether your Authority has taken initiatives (public or internal) to address any issues emerging from the retail holdings of bank debt? If yes, we would appreciate if you could provide us with detail.

31 Question 2: Are you aware of any bank or bank association driven initiatives to address investor protection issues arising from retail investor holdings of bank debt (that could be subject to write-down or conversion to equity or through issuance of recommendation or guidelines)?

Moreover, in 2017 BaFin published a leaflet informing retail investors about the bail-in mechanism and its potential implications for financial instruments concerned and its holders. The brochure is available at the following link (in German only): https://www.bafin.de/SharedDocs/Downloads/DE/Broschuere/dl_b_einlagensicherung.html
In 2017, the Austrian Financial Market Authority (FMA) introduced an increased focus on the distribution of bail-inable debt securities to retail investors when carrying out on-site inspections of institutions or market surveys.

The Portuguese Securities Market Commission (CMVM) intends to introduce suitable measures to ensure investors are informed of bail-in risks, including encouraging financial intermediaries to inform retail investors of the potential risks of self-placement. The intention is to develop a dedicated report to allow institutions to provide relevant data in a consistent and, where feasible, automated way. The CMVM will discuss internally the information to be captured and how to ensure investors are informed of bail-in risk.

During the last 10 years, Consob (the Italian public authority responsible for regulating the Italian financial markets) has put in place several measures to address the risks arising from self-placement of Italian bank bonds, especially to retail clients. First, various supervisory and enforcement actions on banks adopting self-placement distribution models have been conducted including on-site inspections and/or direct inquiries with the banks as well as meetings with their management and compliance and other control functions. Pecuniary sanctions have been imposed. Second, following the implementation of the BRRD, Consob has further focused its supervisory and enforcement actions on banks with a significant concentration of retail clients invested in bail-inable instruments. Third, the authority has published several guidelines and clarifications, which are relevant to banks operating self-placement.

Among these measures, it is relevant to mention the following four clarifications:

1) November 2007: explanatory guidance aimed at specifying the perimeter of investment advice, including by means of examples of business models that can be adopted in order to be compliant with MiFID rules when providing personal recommendations to clients;

2) Consob Communication no 9019104, regarding the intermediary’s duty of correct and transparent behaviour in the distribution of illiquid financial products;

3) 22 December 2014: Consob Communication no 0097996 concerning the distribution of complex financial products to retail investors, with the aim to increase the level of investor protection to retail clients.

4) 24 November 2015: Consob communication no 0090430 reminding firms providing MiFID services that they are required to act honestly, fairly and professionally in the best interests of their clients, including when they distribute financial instruments subject to the BRRD resolution regime; the document mainly focuses on MiFID rules concerning information disclosure to clients and suitability/appropriateness to assess the possible impact of the BRRD resolution regime on their existing processes and procedures;
Consob, these measures contributed to an increase in the proportion of debt retail holdings being distributed on an advice basis (see Figure 10) as well as to a significant overall decrease in domestic retail holdings of bank debt instruments.\footnote{In particular, these decreased from EUR 415.6 billion (38.1% of total retail stock of financial instruments) in December 2011 to EUR 122 billion (12.7% of total retail stock of financial instruments) in September 2017. It should also be noted that approximately two thirds of these debt securities are issued by banks under the SSM. When referring to domestic retail holdings of bank debt instruments issued by the same distributing banks, or other group entities (i.e. self-placement), the decrease registered is from EUR 320.4 billion (29.4% of total retail stock of financial instruments) in December 2011 to EUR 95.6 billion (9.94% of total retail stock of financial instruments) in September 2017.}

\footnote{18 October 2016: Consob Communication no 0092492 aimed at promoting among regulated entities the use of multilateral trading venues (i.e. regulated markets or MTFs) for the distribution of financial instruments, as an effective means to ensure a higher degree of transparency and liquidity through the application of predetermined and efficient negotiation and price formation rules and processes.}
Institution/banking association measures

In Austria, a number of representatives of banking organisations have informed members of the ESMA Statement. In Italy, additional measures have been taken by three bank associations, which published further guidance\(^3\) on the application of the ESMA Guidelines.

In Italy, the Netherlands and Austria, the banking sector has undertaken few initiatives to address investor protection problems arising from retail investor holdings of bank debt. Measures were taken mostly in relation to the publication of the ESMA Statement in 2016.

The Dutch Authority for the Financial Markets (AFM) reported that the ESMA Statement had been discussed with the Dutch Association of Banks and subsequently the Association had circulated the Statement among its members.

\(^3\) The three Italian bank associations have published the following guidance:

1) March 2014: Guidelines from the Italian Banking Association (ABI) providing clarification about the application of the ESMA Guidelines on certain aspects of the MiFID suitability requirements;

2) May 2014: Guidelines from the Italian Association of Financial Intermediaries (ASSOSIM), regarding the suitability/appropriateness test, based on the abovementioned ESMA Guidelines on certain aspects of the MiFID suitability requirements;

3) June 2014: Guidelines from the Italian Association of Italian Cooperative Banks (Federcasse), regarding the provision of investment advice and the assessment of suitability, in which specific measures were also recommended to effectively address the concentration risk.
ANNEX 2. LEGISLATIVE CONTEXT

Background

During the global financial crisis of 2007-2008, the absence of effective tools to manage failing institutions required the use of public funds to restore trust in even relatively small institutions in order to prevent a domino effect of failing institutions from seriously damaging the real economy.

Accordingly, an effective policy framework was needed to manage bank failures in an orderly way and to avoid contagion to other institutions. The aim of such a framework would be to equip the relevant authorities with common and effective tools and powers to address institutions’ failures pre-emptively, while safeguarding financial stability and minimising public finances’ exposure to losses. As a result, significant steps have been taken by regulators to reduce the systemic risk of failing institutions and address the potential spillovers between institutions and sovereigns.

In 2011, the G-20 leaders agreed on an international standard for effective resolution regimes (the Key Attributes), which was developed by the Financial Stability Board and sets out the essential features that should be part of effective resolution regimes in all jurisdictions. The Key Attributes have been implemented in the EU through the adoption of Directive 2014/59/EU (BRRD). In more detail, the BRRD has established an EU framework for the recovery and resolution of institutions, by setting out the roles and responsibilities for institutions, supervisors and resolution authorities prior to resolution (recovery and resolution planning), as an institution begins to weaken (early intervention measures) and in resolution (resolution tools).

The BRRD Framework – relevant aspects

Resolution tools

The BRRD provides resolution authorities with a set of tools (i.e. sale of business, bridge institution, asset separation and bail-in) and powers to intervene sufficiently early and swiftly in the case of a failing institution in order to ensure the continuity of its critical functions, and minimise the impact of its failure on the financial system and the wider economy.

The resolution tools and powers enable resolution authorities, for example, to ensure uninterrupted access to deposits and payment transactions, sell viable portions of the institution where appropriate and apportion losses in a manner that is fair and predictable, with a view to avoiding destabilising financial markets and minimising the use of public funds.

36 The BRRD defines as critical functions ‘those activities, services or operations the discontinuance of which is likely to lead to the disruption of services that are essential to the real economy or to disrupt financial stability’. Such functions may involve activities such as deposit taking, payments, clearing, settlement and custody activities, depending on the materiality of those activities, the degree of complexity and interconnectedness, and the level of substitutability. The BRRD does not predefine a list of critical functions and it is within the resolution authorities’ discretion to identify those functions on a case-by-case basis.
Among the resolution tools, the bail-in tool enables resolution authorities to write down, reduce or convert the liabilities (subject to some exemptions as explained below) of the institution to absorb losses and recapitalise the institution (or the successor entity, if combined with a partial transfer tool) to the level necessary to restore market confidence.

The bail-in tool ensures that shareholders and creditors of the institution under resolution (that is, all creditors, including retail and wholesale holders of debt financial instruments), as opposed to taxpayers, bear the burden of an institution’s failure, with the exception of two cases in which exclusions from losses may occur: (i) some liabilities are automatically excluded from the scope of the bail-in on a mandatory basis; (ii) resolution authorities may make use of their discretionary power to exclude some liabilities from the scope of the bail-in on an ad hoc basis.

Certain liabilities are explicitly exempted from the scope of the bail-in to cater for certain aspects attached to those liabilities that would impose practical barriers to the application of the tool; for example liabilities that are secured, collateralised or otherwise guaranteed, and certain types of unsecured liabilities, including deposits covered by deposit guarantee schemes and liabilities to institutions with an original maturity of less than seven days.

Although retail and wholesale deposits are exempted from the bail-in scope for the amount that is protected by the deposit guarantee schemes (i.e. EUR 100 000), this exclusion does not extend to cover retail debt holders. Retail debt holders receive the same level of protection as any other debt holder that is not subject to a mandatory exclusion. They are therefore within the bail-in scope, contributing to the loss-absorbing capacity of the institution.

**Creditor hierarchy and safeguards**

Most insolvency law principles also underpin the BRRD and include that (i) shareholders and creditors of the institution under resolution bear the costs of resolution in accordance with the order of priority of their claims and (ii) creditors of the same creditor class within the insolvency hierarchy should be treated equally, so-called pari passu treatment.

In addition to the insolvency law principles and in the light of the broad nature of the resolution tools and powers, and their interference with individual property rights, the BRRD provides certain safeguards for shareholders and creditors to ensure that there is certainty on their treatment in resolution, while also allowing resolution authorities to apply their judgement and exercise their discretion as necessary to achieve an effective resolution.

As a result, an important curb to the resolution authorities’ discretion in taking resolution actions is the ‘no creditor worse off’ (NCWO) principle, which ensures that no shareholder and no creditor incur greater losses in resolution than those they would have incurred had the institution been placed into normal insolvency proceedings. The NCWO principle applies to all liabilities irrespective of the type of the holder (e.g. retail or wholesale holder).
Minimum requirement for own funds and eligible liabilities (MREL)

To avoid institutions structuring their liabilities in a way that impedes the effectiveness of the resolution tools, including the bail-in tool, the BRRD requires that institutions meet a robust MREL. The pool of liabilities eligible for MREL is narrower than that of liabilities eligible for bail-in, to make sure that MREL-eligible liabilities are of sufficient quality to cover losses and meet recapitalisation needs in resolution at all times.

To ensure that MREL resources can feasibly and credibly fulfil their role in resolution, the BRRD lists a number of eligibility conditions for liabilities to count as MREL. The MREL eligibility conditions do not rule out retail holdings, and therefore retail liabilities fully count as MREL so long as they meet the eligibility conditions.

The BRRD does not introduce a common minimum MREL level, as is the case with the going-concern capital requirements under the Capital Requirements Directive and Regulation. MREL is to be set on a case-by-case basis by resolution authorities, based on a minimum list of criteria set out in the BRRD that include the size, business model, funding model and risk profile of the institution as well as the potential adverse effects on financial stability of the failure of the institution.

Instruments which are not eligible for MREL are not necessarily excluded from bail-in. A number of instruments will absorb losses in line with their ranking in the creditor hierarchy, although they do not count towards MREL. The MREL eligibility conditions ensure that the highest quality loss-absorbing capacity counts as MREL, while other liabilities should also be readily available to contribute towards loss absorption and recapitalisation as necessary depending on the amount of losses.

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