



Large European banks: Revision to insolvency ranking of preferred bonds



Dr. Susanne Knips
Senior Credit Analyst
T +49 69/91 32-32 11

An amendment to the legal framework governing banks' crisis management introduced in the wake of the financial crisis is on the horizon, a key aspect of which will be the establishment of a general depositor preference throughout Europe. This will have an impact on the ranking of senior preferred bank bonds. However, financial institutions enjoy substantial risk buffers and will be able to mitigate any negative effects by issuing additional preferred notes. As a result, we expect the implications for the ratings of preferred bonds issued by large European banks to be limited.

EU Council adopts common position

On 19 June 2024, the Council of the European Union agreed on a [common negotiating mandate](#) on the review of the crisis management and deposit insurance (CMDI) framework for banks. The aim of the review is to consolidate the EU crisis management framework for banks that was established following the global financial crisis. Among other things, changes are planned to the ranking of customer deposits within the hierarchy of claims against banks. According to the Council's mandate, deposits should benefit from a general preference, increasing the protection from which all depositors benefit in the insolvency ranking (a so-called depositor preference).

Revised hierarchy of claims: adverse impact on ratings of senior preferred bonds ...

A crucial factor from the perspective of bondholders is the effect that the preferential treatment of customer deposits will have on their insolvency ranking. Currently, in some EU countries, including Germany, customer deposits do not enjoy any general preferential treatment. In Germany, for example, the introduction of a general depositor preference would result in deposits from companies over EUR 100,000 being ranked one level higher than senior preferred bonds in the insolvency ranking. Consequently, the amount of insolvency assets within the ranking of senior preferred bonds would fall. This change would therefore have a negative impact on their ratings.

Moody's, for example, factors in the volume of pari passu liabilities (in a so-called loss given default analysis) when assigning a rating. In line with current rating methodology, the agency already assumes a 25-percent probability that, even in countries without a general depositor preference, the competent resolution authority would rank deposits higher than senior preferred bonds in the event of a crisis, meaning that the latter would be more likely to absorb losses. The agency refers to this as the "de facto" scenario. The so-called "de jure" scenario, in other words the equivalent treatment of senior preferred bonds and company deposits above EUR 100,000 in terms of their loss absorption, represents 75 % of the agency's rating assessment. Should the proposal of the EU Council be adopted, the probability of depositor preference throughout Europe would increase to 100 % with detrimental knock-on effects for the ratings of senior preferred bonds.

... but only to a limited extent

In our opinion, the negative effect on ratings of preferred bonds issued by most banks with capital market activities will nonetheless remain limited. Institutions can draw on substantial risk buffers, both in terms of equity and in the form of non-preferred bonds. Alongside asset quality, the funding strategy and MREL ratio are the decisive criteria when it comes to assessing each individual institution.

Current hierarchy of claims in Germany*

Rising seniority, from lowest (bottom) to highest (top)

Covered deposits pursuant to Deposit Guarantee Scheme (up to EUR 100,000)			Hierarchy of claims
Deposits from private and SME customers > EUR 100,000			
Senior preferred	Other deposits > EUR 100,000	Derivatives	
Senior non-preferred			
Tier 2			
AT 1			
CET 1			

*identical in AT, BE, CZ, DE, DK, EE, ES, FI, FR, IE, LV, LT, LU, MT, NL, PL, RO, SE, SK

Customer deposits ranked above senior preferred bonds in BG, CY, EL, HR, HU, IT, PT, SI

Source: Helaba Research & Advisory

New hierarchy of claims as proposed by EU Council

Rising seniority, from lowest (bottom) to highest (top)

Covered deposits pursuant to Deposit Guarantee Scheme (up to EUR 100,000)		Hierarchy of claims
Deposits from private and SME customers > EUR 100,000	Other deposits > EUR 100,000	
Senior preferred	Derivatives	
Senior non-preferred		
Tier 2		
AT 1		
CET 1		

Source: Helaba Research & Advisory

Increase in senior preferred issuance likely

To compensate for this change, those banks affected could issue additional preferred notes in order to increase the volume of insolvency assets available. Accordingly, our assumption is that more preferred bonds will be issued if the proposal to revise the framework is implemented in its current form.

Roadmap: Entry into force not until 2026

As early as April 2023, the **EU Commission** adopted an initial proposal for a legislative package to strengthen the existing bank crisis management and deposit insurance (CMDI) framework. Now, on the basis of this draft proposal, the EU Council can enter into negotiations with the European Parliament. As soon as the legislative process has been completed and published in the Official Journal of the European Union, member states will have 18 months to transpose the changes into national law. For that reason, we do not expect them to enter into force until 2026 at the earliest.



Publications from the "Focus on: Credit" series

- [Large European banks: Well prepared for Basel IV](#)
- [Primary Market Update EUR benchmark bank bonds: Q1 2024](#)
- [Corporate Schuldschein - Primary market Q1 2024](#)
- [APAC covered bonds: Popular instruments with limited supply](#)
- [Large European Banks - Heading into 2024 with strong credit risk buffers](#)
- [European banks: The sharpening contours of ESG disclosure](#)



Sign up for our newsletter here:

<https://news.helaba.de/research/>

Publisher and editor

Helaba Research & Advisory

Editor:

Stefan Rausch

Corporate Research & Advisory

Publisher:

Dr. Gertrud R. Traud

Chief Economist/

Head of Research & Advisory

Neue Mainzer Str. 52-58

60311 Frankfurt am Main

Germany

T +49 69 / 91 32 – 20 24

Internet: www.helaba.com

Disclaimer

This publication was very carefully researched and prepared. However, it contains analyses and forecasts regarding current and future market conditions that are for informational purposes only. The data are based on sources that we consider reliable, though we cannot assume any responsibility for the sources being accurate, complete, and up to date. All statements in this publication are for informational purposes. They must not be taken as an offer or recommendation for investment decisions.