



BaFin

Bundesanstalt für
Finanzdienstleistungsaufsicht

Ref. no.: AG 3-FR 1903-2019/0001 (please state in all cases)

Guidance Notice on the treatment of certain liabilities of CRR institutions under insolvency law

[This is a non-binding convenience translation of the “Merkblatt zur insolvenzrechtlichen Behandlung bestimmter Verbindlichkeiten von CRR-Instituten“. In case of discrepancies between this translation and the German version, the German version prevails under any circumstances.]

Contents (Treatment of certain liabilities of CRR institutions under insolvency law)

Guidance Notice on the treatment of certain liabilities of CRR institutions under insolvency law	3
Date: [2 May 2019]	3
2. Version of section 46f (5) to (7) of the KWG applicable until 20 July 2018	5
“(5) Of the claims within the meaning of section 38 of the InsO, those claims which are not debt instruments in accordance with subsection 6 sentence 1 are adjusted first.	5
III. Background and Objectives	6
<u>Classification of financial products within the scope of section 46f (7) of the KWG (new version) (exemplary)</u>	15
I. Features that <u>do not</u> lead to classification as a debt instrument in accordance with section 46f (7) of the KWG (new version)	15
(1) Fixed coupon	15
(2) Floating coupon based on a standard market reference interest rate with matching maturities	15
(3) Zero coupon	15
(4) Schemes of increasing or decreasing fixed interest rates	15
(5) Fixed agreed individual interest payment and repayment flows	15
(6) Obligations in a foreign currency but ‘secure’ and measurable interest payment and repayment	16
(7) Inverse floating rate note	16
(8) Factorisation	16
(9) Floating rate notes with a 0% floor to avoid negative interest rates	16
(10) Fixed coupon, however with changes according to predefined interest rate types/periods	16
(12) Creditor’s right of notice	17
II. Features that do lead to a classification of the debt instrument in accordance with section 46f (7) of the KWG (new version)	17
(1) Floating coupon with one or more of the following additional features: interest rate floor (fixed or increasing/locked-in), interest rate ceiling, interest rate spread	17
(3) Calculation basis for repayment includes derivatives (e.g. equity derivatives, credit linked notes)	17
(4) Index-linked bond	18
(5) Obligations denominated in a non-deliverable foreign currency for which the interest payments and/or repayment are settled in another deliverable currency	18
(6) Interest rate changes between predefined interest rate types/periods subject to the exercise of a right to chose by the debtor or the creditor	18
(7) Interest rate changes between interest rate types/periods subject to the development of an index	18
(8) Floating coupon is contingent upon longer-term reference interest rates which are, however, quoted regularly and transparently on the market	18

Guidance Notice on the treatment of certain liabilities of CRR institutions under insolvency law

Under the new law exercising the options of the EU Prospectus Regulation and adapting other financial market legislation from 10 July 2018, Federal Law Gazette 2018, p. 1102, the provisions of section 46f (5) to (9) of the German Banking Act (*Kreditwesengesetz* – KWG) (new version) introduced a new regime for the ranking under insolvency law for certain liabilities of CRR institutions (CRR credit institutions and CRR securities firms), implementing Article 108 of Directive 2014/59/EU as amended by Directive (EU) 2017/2399. The amendment to the KWG entered into force on 21 July 2018. For debt instruments issued before the entry into force of the revision, section 46f (5) to (7) of the KWG in the version applicable until 20 July 2018 will continue to apply pursuant to a transitional provision.

Date: [2 May 2019]

I. Introduction and Brief Summary

Already in 2015, section 46f (5) to (7) of the KWG (old version applicable until 21 July 2018) introduced at national level a new ranking class in insolvency and resolution for certain claims from unsecured debt instruments, such as bearer bonds, German *Schuldscheindarlehen* (a special type of promissory notes) and registered bonds. This ranking class was created to provide available loss-absorbing capacity in the event of a resolution with a high degree of legal certainty. International guidelines (TLAC) provide for the definition of a minimum volume of loss-absorbing liabilities for global systemically important banks. Legislators endeavoured to take account of the existing institution-specific minimum requirements for own funds and eligible liabilities (MREL) when implementing these international requirements into Union law.

With the introduction of the new section 46f (5) to (9) of the KWG on 21 July 2018, the regulation introduced in 2015 was adapted to the new requirements of Article 108(2) of Directive 2014/59/EU (hereafter BRRD) as amended by Directive (EU) 2017/2399 (hereafter BRRD amending Directive). For newly issued debt instruments, this marks a transition from the system of statutory subordination chosen in 2015 to the system of contractual subordination stipulated by European law. In order to be classified as a non-preferred liability within the meaning of section 46f (6) of the KWG (new version), the instruments are required in particular to have a contractual maturity of at least one year at the time of issue, and there must be an explicit reference to the lower ranking in the insolvency proceedings as determined by section 46f (5) of the KWG. This is aimed at ensuring transparency for investors and at providing sufficient legal certainty. Institutions now have the option of issuing preferred or non-preferred instruments within the class of normal insolvency liabilities covered by section 38 of the German Insolvency Code (*Insolvenzordnung* – InsO) as a result of the requirement of the explicit reference to the ranking in the contractual terms and conditions and if applicable in the prospectus. At the same time, transitional provisions are also implemented for handling debt securities issued before the entry into force of the implementing act.

In simple terms¹, the new legal position can be described as follows as compared with the previous one:

	Previous legal position (before 21 July 2018)	New legal position (since 21 July 2018)
Senior Preferred	<ul style="list-style-type: none"> • Structured debt instruments • Money market instruments (maturity <1 year) 	<p><u>With issue date as of 21 July 2018:</u></p> <ul style="list-style-type: none"> • Structured debt instruments • Debt instruments with an original maturity of less than one year, or • Debt instruments with contractual terms and conditions that contain no indication of lower ranking in the insolvency proceedings <p><u>With issue date before 21 July 2018:</u> Previous legal position applicable → See left column</p>
Senior Non-Preferred	<ul style="list-style-type: none"> • Non-structured debt instruments that do not represent money market instruments 	<p><u>With issue date as of 21 July 2018:</u></p> <ul style="list-style-type: none"> • Non-structured debt instruments • Original maturity of at least one year and • Contractual terms and conditions or prospectus contain a reference to ranking under insolvency law <p><u>With issue date before 21 July 2018:</u> Previous legal position applicable → See left column</p>

Against this background, the following section first of all compares the old and new versions of section 46f of the KWG (see section II.) and explains the background and objectives of the revision (see section III.). Subsequently, the individual features of debt instruments within the meaning of section 46f (6) of the KWG (new version) are examined in further detail (see section IV.). There then follows a brief discussion of the previous regulation in accordance with section 46f (6) of the KWG (old version), which continues to be relevant for debt instruments issued before 21 July 2018 in accordance with section 46f (9) of the KWG (new version) (see no. V.).

¹ The following illustration is limited to the (incomplete) presentation of some essential aspects in the interests of improved legibility; further details are provided in points II-V of this Guidance Notice.

II. Old and new versions of section 46f of the KWG

1. New version of section 46f (5) to (9) of the KWG applicable as of 21 July 2018

“(5) Of the claims within the meaning of section 38 of the Insolvency Code, those claims which are not debt instruments in accordance with subsection 6 sentence 1 must be satisfied first.

(6) Debt instruments within the meaning of this sentence are bearer bonds and bonds payable to order as well as rights comparable to such bonds which by their nature are admitted to trading on the capital markets, as well as German *Schuldscheindarlehen* and registered bonds which are not deposits referred to in subsection 4 nos. 1 or 2, which have a contractual maturity of at least one year at the time of issue, provided that the contractual terms and conditions of the debt instrument expressly refer to the lower ranking in insolvency proceedings as determined by subsection 5. The reference must also be included in any prospectus that is published on a mandatory basis. Debt instruments which fall within the scope of application of section 91 (2) of the Recovery and Resolution Act, and debt instruments issued by public law institutions which are not subject to insolvency proceedings are not considered to be debt instruments within the meaning of sentence 1.

(7) Subsection 6 sentence 1 does not apply to debt instruments for which the parties have agreed

1. that the repayment amount is contingent upon the occurrence or non-occurrence of an event which is still uncertain at the time the debt instrument is issued, or is settled otherwise than by cash payment, or
2. that the amount of interest paid is contingent upon the occurrence or non-occurrence of an event which is still uncertain at the time the debt instrument is issued, unless the amount of the interest payment is solely contingent upon a fixed or standard market floating reference interest rate and settlement is made through a cash payment. The repayment amount or amount of interest paid must not be considered to be contingent upon the occurrence or non-occurrence of an event that is still uncertain at the time that the debt instrument is issued solely because the debt instrument is in a currency other than the national currency of the issuer, provided that the principal claim, the repayment and the claim for interest are in the same currency.

(8) The Federal Ministry of Finance is authorised to issue a regulation providing for more detailed provisions on the features of the debt instruments covered by the scope of application of subsection 7 by means of a statutory instrument which will not require the approval of the German Bundesrat. The Federal Ministry of Finance may transfer the authorisation to issue the regulation pursuant to sentence 1 to the Federal Financial Supervisory Authority by statutory order.

(9) Section 46f (5) to (7) of the KWG in the version applicable until 20 July 2018 continues to apply to debt instruments issued before 21 July 2018. In the event of insolvency proceedings, debt instruments issued before 21 July 2018 within the meaning of section 46f (6) sentence 1 of the KWG in the version applicable until 20 July 2018 have the same ranking as debt instruments within the meaning of subsection 6 sentence 1.”

2. Version of section 46f (5) to (7) of the KWG applicable until 20 July 2018

“(5) Of the claims within the meaning of section 38 of the Insolvency Code, those claims which are not debt instruments in accordance with subsection 6 sentence 1 must be satisfied first.

(6) Debt instruments within the meaning of this sentence are bearer bonds and bonds payable to order as well as rights comparable to such bonds which by their nature are admitted to trading on the capital markets, as well as German *Schuldscheindarlehen* and registered bonds which are not deposits referred to in subsection 4 nos. 1 or 2. Debt instruments which fall within the scope of application of section 91 (2) of the Recovery and Resolution Act, and debt instruments issued by public law institutions which are not capable of becoming insolvent as well as money market instruments are not considered to be debt instruments within the meaning of sentence 1.

(7) Subsection 6 sentence 1 does not apply to debt instruments for which the parties have agreed

1. that the repayment amount is contingent upon the occurrence or non-occurrence of an event which is still uncertain at the time the debt instrument is issued, or is settled otherwise than by cash payment, or
2. that the amount of interest paid is contingent upon the occurrence or non-occurrence of an event which is still uncertain at the time the debt instrument is issued, unless the amount of the interest payment is solely contingent upon a fixed or floating reference interest rate and settlement is made through a cash payment."

III. Background and Objectives

The background to the revision of section 46f of the KWG is the amendment of Article 108 of the BRRD through the BRRD amending Directive. The BRRD amending Directive in turn serves to implement the Total Loss-Absorbing Capacity (TLAC) Term Sheet published by the Financial Stability Board (FSB) on 9 November 2015. The revision of section 46f of the KWG implements the requirements of the amended Article 108(2) of the BRRD.

The aim of the TLAC standard is to ensure that sufficient loss-absorbing and recapitalisation capacities are available to global systemically important banks in particular, so that the critical functions of these banks can be maintained in the event that they are failing or likely to fail, without resorting to public funds or endangering financial stability on the markets. The TLAC standard provides that global systemically important banks must meet the minimum requirements for loss-absorbing and recapitalisation capacity with subordinated liabilities, in order to minimise the risk of creditors being placed in a worse position than in normal insolvency proceedings when using the bail-in instrument and to ensure the highest possible level of legal certainty. Under the BRRD amending Directive, certain unsecured debt instruments should be able to achieve a special ranking in insolvency according to the creditor hierarchy in order to establish this subordination as effectively as possible. This ranking should be designed on the one hand in such a way that the instruments to be classified there continue to have senior ranking over instruments that are subordinated by contract. On the other hand, these debt instruments should be subordinated to liabilities for which application of the bail-in tool would likely involve operational and legal difficulties, or for which application of the bail-in tool would lead to significant contagion risks for the financial market (see the Bundestag printed paper 19/2435, p. 54 et seq.).

Just as with the regulation under section 46f (5) to (7) of the KWG (old version) applicable until 20 July 2018, the revision provides for ranking in insolvency exclusively within that class of liabilities of CRR institutions which constitute insolvency claims for the creditors concerned in accordance with section 38 InsO. With regard to claims of the creditors of a CRR institution within the meaning of section 38 of the InsO, those

claims which are not debt instruments pursuant to section 46f (6) sentence 1 of the KWG (new version) are to be satisfied first in insolvency proceedings pursuant to section 46f (5) of the KWG.

Furthermore, the revision does not affect the classification of liabilities which has been applicable so far and which represent subordinated insolvency claims for the respective creditors within the meaning of section 39 of the InsO. These subordinated insolvency claims within the meaning of section 39 of the InsO retain their previous ranking in insolvency compared with the other remaining insolvency claims within the meaning of section 38 of the InsO. The subordinated liabilities of CRR institutions in accordance with section 39 of the InsO include additional Tier 1 capital instruments and Tier 2 capital instruments as well as other liabilities that are subordinated based on a contractual provision in the event of the insolvency of the CRR institution.

In addition to determining the ranking for satisfaction in the event of insolvency proceedings, the provision in section 46f of the KWG also has an impact in the event of a resolution of a CRR institution in accordance with the provisions of the German Recovery and Resolution Act (*Sanierungs- und Abwicklungsgesetz* – SAG) or the SRM Regulation (EU) (SRMR). The resolution authority may *inter alia* use the bail-in tool if the requirements for a resolution of an institution pursuant to Article 18 of the SRMR or section 62 of the SAG are met (Article 27 of the SRMR, section 90 of the SAG). Within the scope of this tool, eligible liabilities (Article 27 (3) of the SRMR, section 91 (1) of the SAG) may be written down or converted into the institution's own funds for recapitalisation purposes. The resolution authority must follow the ranking for the claim under national insolvency law or the prescribed liability cascade (Article 17 of the SRMR, section 97 (1) of the SAG).² Eligible liabilities are accordingly only subject of a bail-in after use of the quota shares and other instruments of the common equity Tier 1 capital, the additional Tier 1 capital and the Tier 2 capital. Liabilities must be included in accordance with the ranking under insolvency law within the group of eligible liabilities (Article 17 (1) of the SRMR, section 97 (1) sentence 3 of the SAG).

As a result of the ranking regulation under section 46f (5) of the KWG, the resolution authority must first include all liabilities from unsecured debt instruments covered by section 46f (6) of the KWG (new version) among the eligible liabilities, before the other non-subordinated liabilities of the CRR institution can be used when applying the bail-in tool. Based on the resolution principles laid down in section 68 (1) of the SAG, when applying resolution tools, the resolution authority must ensure that losses are borne by shareholders and creditors to the same extent as in the case of insolvency proceedings that would have been opened at the time the resolution was ordered (section 68 (1) no. 1 of the SAG).

Debt instruments within the meaning of section 46f (6) (old version) issued before 21 July 2018 have the same ranking as those issued under the scope of application of section 46f (6) of the KWG (new version) in accordance with section 46f (9) of the KWG (new version).

² See the Guidance Notice "Overview of the liability cascade in bank resolution" available on the Federal Financial Supervisory Authority's website https://www.bafin.de/SharedDocs/Veroeffentlichungen/EN/Merkblatt/BA/mb_haftungskaskade_bankenabwicklung_en.html cid363.

IV. Debt Instruments within the meaning of section 46f (6) of the KWG (new version)

According to sentence 1, debt instruments within the meaning of section 46f (6) of the KWG (new version) are all bearer bonds and bonds payable to order as well as rights comparable to these debt instruments that are admitted to trading on the capital markets by their nature, as well as German *Schuldscheindarlehen* and registered bonds that are not deposits within the meaning of section 46f (4) nos. 1 and 2 of the KWG. The debt instruments covered by section 46f (6) sentence 1 of the KWG (new version) must also have a contractual maturity of at least one year at the time of issue. In addition, the contractual terms and conditions of the debt instrument must expressly refer to the lower ranking in the insolvency proceedings as defined in section 46f (5) of the KWG.

1. Debt instruments in the form of covered deposits and deposits eligible for compensation pursuant to section 46f (4) nos. 1 and 2 of the KWG

Firstly, in accordance with section 46f (6) sentence 1 of the KWG (new version), debt instruments that are deposits in accordance with section 46f (4) no.1 or 2 of the KWG are excluded.

Section 46f (4) nos. 1 and 2 of the KWG on the one hand comprise covered deposits in accordance with section 2 (3) no. 23 of the SAG in conjunction with section 2 (5) of the German Deposit Guarantee Act (*Einlagensicherungsgesetz* – EinSiG), as well as claims which have been transferred to the deposit guarantee scheme in accordance with section 16 of the EinSiG, as well as deposits eligible for compensation in accordance with section 2 (3) no. 18 of the SAG in conjunction with section 2 (4) of the EinSiG of individuals, microenterprises and small and medium-sized enterprises, as well as those deposits at institutions domiciled in the European Union which would have been eligible for compensation if they had not been accepted by their branches outside the European Union.

As the wording of section 46f (6) sentence 1 of the KWG already suggests, this exception only applies to German *Schuldscheindarlehen* and registered bonds. Bearer bonds and registered bonds are financial instruments in accordance with section 2 (4) no. 1 of the German Securities Trading Act (*Wertpapierhandelsgesetz* – WpHG). The resulting credit balances can accordingly only be evidenced through a financial instrument. This means that they are not deposits within the meaning of the EinSiG (see section 2 (3) sentence 2 of the EinSiG).

a) German *Schuldscheindarlehen*

Credit balances from German *Schuldscheindarlehen* represent covered deposits or deposits eligible for compensation, provided that the German *Schuldscheindarlehen* is not structured as a money market instrument within the meaning of section 2 (2) of the WpHG, i.e. as a financial instrument, and can only be evidenced by this, and that the other requirements of the EinSiG (in particular section 6 of the EinSiG) are met.

b) Registered bonds

Registered bonds are also generally financial instruments within the meaning of section 2 (4) of the WpHG. However, under section 2 (4) of the WpHG in conjunction with section 1 (2) of the German Capital Investment Act (*Vermögensanlagegesetz* – VermAnlG), registered bonds with an agreed fixed term

and an unchangeable agreed fixed positive interest rate, where the invested capital is repaid at full nominal value at the time of maturity without deduction of interest, and which are issued by a CRR credit institution within the meaning of section 1 (3d) sentence 1 of the KWG that has been granted a licence in accordance with section 32 (1) of the KWG, are not financial instruments if the capital paid up on them is not repaid only after all non-subordinated creditors have been satisfied in the event of insolvency proceedings in relation to the assets of the institution or the liquidation of the institution. Furthermore, savings products in the form of a certificate of deposit made out to a named individual which already existed as of 2 July 2014 are also deposits within the meaning of section 2 (3) of the EinSiUG, when they constitute a financial instrument (see section 2 (3) sentence 2 no. 1 of the EinSiG).

- c) Distribution of the coverage level in accordance with section 8 of the EinSiG with due regard to the insolvency ranking classes pursuant to section 46f of the KWG (new version).

If a depositor has several deposits eligible for compensation with an institution which together exceed the coverage level in accordance with section 8 of the EinSiG, the issue arises as to how the individual claims are taken into account in the distribution of the coverage level and which claims are regarded as low-ranking debt instruments pursuant to section 46f (5) of the KWG, and at what amount. In the absence of an explicit provision in section 46f of the KWG or in the EinSiG, an analogous application of section 366 (2) of the German Civil Code (*Bürgerliches Gesetzbuch* – BGB) is possible for the purposes of the distribution of the coverage level. This means that the coverage level under section 8 of the EinSiG must be allocated first of all among those deposits which would have the lower insolvency ranking if they were not covered by section 46f (4) of the KWG. The following example is used to illustrate this:

A large enterprise outside of the financial sector is entitled to the following claims against a German CRR credit institution from deposits eligible for compensation within the meaning of section 2 (3) no. 18 of the SAG and section 2 (4) of the EinSiG:

- claims from term deposits in the amount of EUR 50,000;
- claims from a German *Schuldscheindarlehen* in the amount of EUR 200,000 which is structured as a deposit eligible for compensation.

The sum of these deposits eligible for compensation exceeds the coverage level of the statutory deposit guarantee provided for in section 8 (1) of the EinSiG by EUR 150,000. Increases in the coverage level within the meaning of section 8 (2) of the EinSiG are not relevant.

Although a term deposit of a large enterprise is a deposit eligible for compensation within the meaning of section 2 (4) of the EinSiG, it does not take part in the priority ranking in accordance with section 46f (4) no. 2 of the KWG which only applies to deposits of those depositors referred to in it (individuals, microenterprises and small and medium-sized enterprises). Nevertheless, the term deposit at the amount of the coverage level is also a covered deposit for the large enterprise and would fall entirely within the preferential insolvency ranking class in accordance with section 46f (4) no. 1 of the KWG, without taking the German *Schuldscheindarlehen* into account. The German *Schuldscheindarlehen* has the low ranking in accordance with section 46f (5) in conjunction with section 6 of the KWG (new version), but the coverage level also falls within the preferred ranking class for covered deposits in accordance with section 46f (4) no. 1 of the KWG.

Following an analogous application of section 366 (2) of the BGB, the coverage level of EUR 100,000 must be allocated in full to the German *Schuldscheindarlehen* with its lower ranking as compared to the claim from term deposits as of section 46f (6) sentence 1 of the KWG (new version). The German *Schuldscheindarlehen* of EUR 100,000 must therefore be settled as a priority in accordance with section 46f (4) no. 1 of the KWG in the event of insolvency. The remaining claim of EUR 100,000 from the German *Schuldscheindarlehen* falls under section 46f (6) sentence 1 of the KWG and is therefore ranked after the claims in accordance with section 46f (5) of the KWG. The term deposits in the amount of EUR 50,000 represent senior debt for the large company in accordance with section 46f (5) of the KWG with respect to claims in accordance with section 46f (6) sentence 1 of the KWG.

2. Exceptions within the meaning of section 46f (6) sentence 2 of the KWG (new version)

In accordance with sentence 2, debt instruments which are debt instruments within the meaning of section 46f (6) of the KWG are excluded if they fall within the scope of section 91 (2) of the SAG. This includes all collateralised liabilities including, for instance, liabilities from covered bonds, provided that these are at least collateralised or covered by the value of the collateral provided for this purpose (section 91 (2) no. 2 of the SAG). However, the unsecured portion of these debt instruments is not covered by this exception and therefore falls within the scope of section 46f (6) sentence 1 of the KWG (new version).

Debt instruments issued by public-law institutions that are not subject to insolvency proceeding are also not considered debt instruments within the meaning of section 46f (6) sentence 1 of the KWG (new version). Whether or not a legal entity under public law is subject to insolvency proceedings results from the respective applicable federal law or from the applicable state law in accordance with section 12 (1) no. 2 of the InsO.

In accordance with section 46f (6) sentence 2 of the KWG applicable until 21 July 2018, money market instruments were also expressly excluded from the term “debt instruments” within the meaning of section 46f (6) sentence 1 of the KWG (old version). Since section 46f (6) sentence 1 of the KWG (new version) only covers debt instruments with an original contractual maturity of at least one year, claims which are normally traded on the money market are typically not included in the term “debt instruments” within the meaning of Section 46f (6) sentence 1 of the KWG (new version) simply because of the requirement of a minimum maturity of one year.³ An express statutory exclusion was therefore not implemented (Bundestag printed paper 19/2435, p. 56).

3. Reference to ranking under insolvency law

a) Reference in the contractual terms and conditions

In accordance with the requirements of the BRRD amending Directive (see Article 108(2)(c)), section 46f (6) sentence 1 of the KWG (new version) requires an explicit reference to the lower ranking in insolvency proceedings determined by section 46f (5) of the KWG in the contractual terms and conditions of the debt instruments. This is aimed at ensuring transparency for investors and creating adequate legal certainty. The regulation also allows institutions to issue instruments whether these are preferred or not (see Bundestag printed paper 19/2435, p. 56).

³ See also section V. for further details regarding money market instruments

b) Format for the reference in the prospectus

A corresponding reference must also be included in the prospectus if a prospectus is mandatory under the applicable provisions. The contractual terms and conditions for debt instruments are normally reproduced in its original wording in the prospectus. If the contractual terms and conditions contain a reference to the lower ranking under insolvency law determined by section 46f (5) of the KWG, this reference must therefore also be included in the prospectus. If the contractual terms and conditions are not included in the prospectus with the reference to the lower ranking under insolvency law determined by section 46f (5) of the KWG, the prospectus must contain a separate reference to the ranking under insolvency law that is labelled accordingly. Reference is also made to Article 16(2) of Regulation (EU) 2017/1129, according to which the risk factors also include the risks resulting, inter alia, from the degree of subordination of a security in accordance with the BRRD.

c) Reference in the prospectus with offering programmes

The regulations under prospectus law allow the preparation of prospectuses for offering programmes by means of base prospectuses. These base prospectuses may also provide for the issue of different categories of debt securities under the same prospectus.

The general principles for the drafting of base prospectuses apply if debt securities with different rankings under insolvency law are to be issued under any such base prospectus, i.e. both debt instruments which are preferred and not preferred under insolvency law. The individual disclosures in the prospectus for the different categories must be clearly and unambiguously attributable to these categories. With the reference to the ranking under insolvency law required under section 46f (6) sentence 1 of the KWG (new version), the category of debt instrument to which this refers must therefore be clearly identifiable.

4. Structured financial products within the meaning of section 46f (7) of the KWG (new version)

In accordance with section 46f (7) of the KWG (new version), claims from debt instruments within the meaning of section 46f (6) sentence 1 of the KWG (new version) are excluded from the special insolvency rule if the repayment amount or amount of interest paid is contingent upon the occurrence or non-occurrence of an event that is still uncertain at the time the debt instrument is issued. This is intended to exclude certain structured financial products and to comply with the requirements of the new Article 108 (2) (b) of the BRRD. Accordingly, debt instruments themselves must not be derivatives or contain embedded derivatives. The exclusion of these types of financial products from the special insolvency rule can be explained by potential difficulties in the valuation of the products and insufficient certainty regarding the amount available within the scope of applying the bail-in tool.

However, the instruments are not excluded in principle if the amount available is sufficiently certain and the valuation can be made without any major effort. Debt instruments in accordance with section 46f (7) no. 2 of the KWG (new version) are specifically not excluded if the amount of interest paid is contingent exclusively upon a standard market floating reference interest rate. Provided that the reference interest rate represents an appropriate interest rate for the respective coupon periods (i.e. interest is determined with matching maturities, with the interest calculation periods for the coupon and the reference interest rate coinciding), the valuation does not require any major effort and there is certainty as to the amount available (see Bundestag printed paper 19/2435, p.56 et seq.).

Matching maturities are not ensured if coupon payments are determined based on longer-term interest rates, e.g. annual coupon payments based on a ten-year swap rate observed at the coupon dates. Applying a ten-year interest rate for a single year is not reasonable, and appropriate financial market models are normally required for valuation purposes. However, the complexity of the valuation is considered reasonable if the interest rate is based on a standard market reference interest rate at matching maturities. The standard market reference interest rates currently applied in particular are EURIBOR, EONIA and LIBOR. Other reference interest rates may be considered for other currencies, provided that these reflect an appropriate rate of interest in the relevant currency. Alternatives such as Ester, Sonia or SOFR will also be considered customary in the future in light of current reforms to reference interest rates.

In accordance with section 46f (7) sentence 2 of the KWG (new version), the repayment or amount of interest paid is not to be regarded as being affected by the occurrence of an uncertain event simply because the debt instrument is denominated in a currency other than the national currency of the issuer. Foreign currency bonds can be valued with little effort, provided that any possible interest is paid in the same currency as the principal amount invested and the repayment amount and is therefore only subject to the currency risk between the euro and the relevant foreign currency. This provision is also in line with the requirements of the BRRD amending Directive (see Article 108(6)). Equally, the issue of a debt instrument in a foreign currency alone did not result in this being classified as a structured financial product in the version of section 46f (7) of the KWG valid until 20 July 2018.

Furthermore, the granting and structuring of rights of termination in the contract does not mean in and of itself that the debt instruments fall under the provisions of section 46f (7) of the KWG (new version). Contractual rights of termination only affect the timing of repayment and not, however, the repayment amount. Rights of termination for both, the creditor and the issuer, are therefore generally irrelevant in terms of classification as a structured financial product. This also applies in the event that the issuer has a right to early repayment. This is because the timing of the due date of debt instruments alone does not result in significant difficulties when these are being valued in a resolution procedure. To this extent also, the revision of section 46f (7) of the KWG as of 21 July 2018 does not result in any change compared to the legal situation existing up until that date.

Examples for the classification of financial products within the scope of section 46f (7) of the KWG (new version) can be found in the Appendix to this Guidance Notice.

V. Transitional provision in accordance with Section 46f (9) of the KWG (new version)

Section 46f (5) to (7) of the KWG in the version applicable until 20 July 2018 will continue to apply to debt instruments issued before entry into force of the revision of section 46f of the KWG on 21 July 2018 as a result of the transitional provision in section 46f (9) of the KWG (new version). Against this background, the exceptions for money market instruments contained in section 46f (6) sentence 2 of the KWG (old version) are explained in more detail below.

In accordance with section 1 (11) sentence 3 of the KWG⁴, money market instruments are deemed to be instruments within the meaning of Article 11 of Delegated Regulation (EU) 2017/565 with the exception of instruments of payment. In accordance with Article 11 of Delegated Regulation (EU) 2017/565 on the other hand, with reference to Article 4(1) no. 17 of Directive 2014/65/EU, money market instruments include treasury bills, certificates of deposit, commercial papers and other instruments with essentially the same features, provided that their value can be determined at any time and that they are not derivatives. This understanding of the concept of money market instruments was also used as the basis for the predecessor norm of section 1 (11) sentence 2 of the KWG. Under this provision, money market instruments were defined as all types of claims that are normally traded on the money market, with the exception of instruments of payment. These include, inter alia, the aforementioned treasury bills, certificates of deposit and commercial papers.⁵ The duration of the term of the provision of capital is a further feature used to distinguish between the money and capital markets. The conventional understanding under the KWG was that the dividing line between the capital market and the money market is generally at a maturity of 12 months or 365 days, or 366 days in the case of a leap year⁶. This understanding of the distinction between money and capital markets must be maintained when applying section 46f of the KWG (old version), also in view of the provision of Article 11 of Delegated Regulation (EU) 2017/565 which has been in force since 3 January 2018. Article 11 provides for a maturity of up to 397 days for the general definition of money market instruments in section 1 (11) sentence 3 of the KWG and section 2 (2) of the Securities Trading Act. The aforementioned Delegated Regulation relates exclusively to the definition of permissions or rather exemptions, the concept of financial enterprise and the definition of financial collateral. This provision is therefore in no way connected with the subject matter and purpose of section 46f of the KWG, with the result that the scope for action by national legislators with respect to section 46f of the KWG is not affected by this provision. The scope of the definition must therefore be determined solely based on national law, taking into account the regulatory objectives. Legislators only had the adaptation to the aforementioned Delegated Regulation in mind when amending the general definition in section 11 (3) of the KWG and section 2 (2) of the Securities Trading Act, and not considerations as regards to avoiding systemic risks and guaranteeing the resolvability of banks⁷. It follows that by changing the general definition of the term in section 1 (11) sentence 3 of the KWG, legislators did not intend to make any substantive changes within the scope of section 46f of the KWG. Legislators also applied this understanding to the revision of section 46f of the KWG. This is demonstrated by the fact that legislators discarded the special provision on money market instruments as unnecessary regulation and justified this by the fact that debt instruments with a maturity of no more than one year would not be covered in principle anyway under the revision (see Bundestag printed paper 19/2435, p. 56).

⁴ In the version valid from 3 January 2018

⁵ See Schäfer in Boos/Fischer/Schulte-Mattler in *Kreditwesengesetz*, 5th edition, section 1 para. 286.

⁶ See BaFin Guidance Notice "*Hinweise zu Finanzinstrumenten nach § 1 Absatz 11 Satz 1 Nummern 1 bis 7 KWG*" [Guidance Notes on Financial Instruments] from 20 December 2011, under subsection 2b) sub-item gg) "*Geldmarktinstrumente*".

⁷ See Bundestag printed paper 18/10936, p. 220 (amendment to section 2 of the German Securities Trading Act (*Wertpapierhandelsgesetz* - WpHG), p. 257 (amendment to section 1 of the KWG).

It follows from the above that money market instruments issued before 21 July 2018 are only privileged if they have a maximum maturity of 365/366 days. Money market instruments with a longer maturity may fall under section 46f (6) of the KWG (old version) in individual cases if the requirements in terms of content stated there are met⁸. This leads to legal certainty for institutions when fulfilling their reporting obligations in accordance with Article 11(1) of the BRRD in conjunction with Section B of the Annex to the Directive (Liability Data Report). The period is calculated based on the original term and not the remaining term of the issue.

⁸ With regard to the legal situation prior to 3 January 2018, reference is made in this respect to the previous interpretative guidance of section 46f of the KWG.

Appendix

Classification of financial products within the scope of section 46f (7) of the KWG (new version) (exemplary)

The following examples describe, at first, features which result in debt instruments not falling within the scope of section 46f (7) of the KWG (new version). Thereinafter, features are described for such debt instruments that do fall within the scope of this provision.

I. Features that do not lead to classification as a debt instrument in accordance with section 46f (7) of the KWG (new version)

The following features of a debt instrument lead to the fact that the debt instrument does not fall within the scope of section 46f (7) of the KWG (new version):

(1) Fixed coupon

Example: '5%' or another fixed interest rate over the entire term or 'issue price = repayment price' (issued at 0% or equally at a negative interest rate)

The repayment or interest payment, or the repayment amount or amount of interest paid is not contingent upon an event which is uncertain at the time of issue.

(2) Floating coupon based on a standard market reference interest rate with matching maturities

Example: 'Quarterly payments of 3-month EURIBOR +/- 150 basis points'

In such a case, the coupon is determined by the reference interest rate plus/minus the premium (spread or margin). Here the amount of interest paid is exclusively contingent upon a fixed premium and a floating reference interest rate that is appropriate for the respective coupon period.

(3) Zero coupon

Example: 'Issue price €50, repayment amount of €100, ten-year term, no coupons'. In the case of an instrument with a zero-coupon, the interest accrued on the nominal value is determined in advance subject to the contractual agreements and is not variable. The repayment amount or the amount of interest paid is not contingent upon an uncertain event at the time of issue.

(4) Schemes of increasing or decreasing fixed interest rates

Example: '2% in year 1, 3% in year 2 or 5% in year 1, 4% in year 2'

In such an arrangement, the interest payments and repayments are determined in advance. The repayment amount or amount of interest paid is not contingent upon an uncertain event at the time of issue.

(5) Fixed agreed individual interest payment and repayment flows

Example: 'Investor pays €100 at the beginning, receives €5 in interest in year 1, €3 in interest and a repayment of €20 in year 2, €5 in interest and a repayment of €80 in year 3'

The interest payments, final repayment amount and claims during the term are fixed in advance due to the amortising structure. The repayment amount or amount of interest paid is not contingent upon an uncertain event at the time of issue.

(6) Obligations in a foreign currency but 'secure' and measurable interest payment and repayment

Example: 'Instrument in USD nominal terms with fixed or variable coupon, repayment in USD at 100'

The interest payments, final repayment amount and claims within the term are predefined. The fact that the instrument is denominated in a foreign currency is not a reason to exclude the claim from the special insolvency rule in accordance with section 46f (7) sentence 2 of the KWG (new version).

(7) Inverse floating rate note

Example: Quarterly payments of '5% - 3-month EURIBOR'

The amount of interest paid is exclusively contingent upon a standard market reference interest rate with matching maturities (development of the 3-month EURIBOR).

(8) Factorisation

Example: Interest payment is in a quarterly interest period of the type '3-month EURIBOR x factor'.

The amount of interest paid is exclusively contingent upon a reference interest rate. This assessment is not affected by the fact that a multiplication or addition is carried out.

(9) Floating rate notes with a 0% floor to avoid negative interest rates

Example: '0% floor for the coupon is expressly stated in the terms and conditions of the bond or is implicit from its interpretation'

Negative interest rates raise legal problems, meaning that, under certain circumstances, an implicit interest rate limit (floor) of 0% can be interpreted as agreed upon even in the absence of an explicit contractual provision. If a 0% floor is included in the contractual documentation for clarification purposes, this does not create a structured product that falls under the provisions of Section 46f (7) of the KWG (new version).

(10) Fixed coupon, however with changes according to predefined interest rate types/periods

Example: '2% fixed in years 1 and 2, then quarterly 3-month EURIBOR + 150 basis points until end of the term'

Interest payments, final repayment amount and the claims within the term are predefined for all periods; the sequence of periods is also determined in advance. Thus there is no uncertain event upon issue within the meaning of section 46f (7) of the KWG.

(11) Debtor's right of notice

Example: 'Maximum term ten years, issuer has annual right of notice after five years; repayment amount (e.g. 100%) is predefined'

(12) Creditor's right of notice

Example: 'Maximum term ten years, creditor has the right to demand early repayment annually after five years; repayment amount (e.g. 100%) is predefined'.

The repayment amount is predefined in cases (11) and (12) and not contingent upon an uncertain event.

(13) EONIA floater

Example: Interest payments are determined daily based on the EONIA rate and paid cumulatively on certain dates, e.g. quarterly.

EONIA is currently the reference interest rate for the adequate daily interest rate in the eurozone. The cumulative payment of the interest calculated daily at the end of a period does not contradict the aspect of matching maturities.

(14) Coupon reset note

Example: Coupons are adjusted every five years to a standard market five-year swap rate.

As the term for the swap is the same as the interest rate fixation period, maturities match and the valuation of the coupon reset note does not require material effort.

II. Features that do lead to a classification of the debt instrument in accordance with section 46f (7) of the KWG (new version)

The following features of a debt instrument place the debt instrument within the scope of section 46f (7) of the KWG (new version):

(1) Floating coupon with one or more of the following additional features: interest rate floor (fixed or increasing/locked-in), interest rate ceiling, interest rate spread

Example: '3-month EURIBOR, minimum 2%, maximum 4%'; '3-month EURIBOR, each fixed coupon becomes the interest rate floor for subsequent periods'.

The amount of interest paid is uncertain at the time of issue within the meaning of section 46f (7) no. 2 of the KWG (new version). The corresponding exemption in the case of an exclusive linking to a reference interest rate does not apply, as the interest rate is structured as a derivative in addition to the linking to a reference interest rate (limiting the individual interest payments contains an additional derivative in the form of a cap, floor or collar).

(2) Calculation basis for interest payment includes derivatives

Example: 'Coupon = number of days during which a reference interest rate lies within a range'

Although the amount of the coupon payment is contingent solely upon a reference interest rate, the corresponding exemption does not apply as the coupon payment represents a derivative on the interest payment.

(3) Calculation basis for repayment includes derivatives (e.g. equity derivatives, credit linked notes)

Example: 'Repayment at 100 or performance of the DAX over time if higher (capital guarantee)'

In this arrangement, the repayment amount is contingent upon an uncertain event. It contains an equity derivative which, according to the explanatory memorandum from section 46f (6) of the KWG, must be exempted. Here is therefore an uncertain event at the time of the issue in accordance with section 46f (7) no. 1 of the KWG.

(4) Index-linked bond

Example: 'Repayment amount or amount of interest paid is linked to the development of an index'

In the case of index-linked bonds (e.g. inflation-linked bonds), depending on the structure chosen, the repayment amount or amount of interest paid are contingent upon an uncertain event. The index itself does not constitute a permissible reference interest rate within the meaning of section 46f (7) no. 2 of the KWG (new version).

(5) Obligations denominated in a non-deliverable foreign currency for which the interest payments and/or repayment are settled in another deliverable currency

Example: 'Obligation to pay in Brazilian real (BRL) nominal terms with fixed or floating coupon, repayment in USD at a future exchange rate'

The repayment amount and/or the amount of interest paid are contingent upon a future event (development of the exchange rate). The corresponding exemption for payments denominated in another currency does not apply, as the principal claim, repayment and interest claim are not in the same currency.

(6) Interest rate changes between predefined interest rate types/periods subject to the exercise of a right to choose by the debtor or the creditor

Example: '2% fixed in years 1 and 2. At the end of the two years, the debtor or creditor can decide whether the interest payment should be set at 2.5% or the 3-month EURIBOR + 200 basis points'

The amount of interest payment is not clearly defined at the time of issue as a result of the debtor's or creditor's right or option to choose. The amount of the interest payment therefore is contingent upon an uncertain event at the time of issue (exercise of the option to choose).

(7) Interest rate changes between interest rate types/periods subject to the development of an index

Example: 'Fixed coupon for 2-years, interest payments in subsequent years contingent upon performance of the DAX'

The fact that the instrument contains at least one interest rate period in which the uncertainty regarding the interest rate level is not only contingent upon a reference interest rate, results in the instrument being recognised in accordance with section 46f (7) no. 2 of the KWG (new version) for its entire term. This applies irrespective of whether the 'structured' interest period is at the beginning, in the middle or at the end of the term.

(8) Floating coupon is contingent upon longer-term reference interest rates which are, however, quoted regularly and transparently on the market

Example: 'CMS bond with annual coupons equal to the amount of the ten-year swap rate'

With constant maturity swap (CMS) bonds, coupons are adjusted regularly (annually in the example) to a

longer-term reference rate (ten-year swap rate). However, even when the longer-term interest rate is a standard market reference rate, the resulting payments are not adequate for a single year and are not customary for coupon payments. There are no guarantees that the valuation can be implemented without major effort in the event of a resolution.