



## BAIL IN and RESOLUTION FINANCING in BRRD

### INTERVENTION INSTRUMENTS

#### Resolution tools

##### Sale of business tools

The Resolution Authority (RA) can force the selling or transfer of shares, assets and liabilities of the failing institution to the market

##### Bridge institution tool

The RA can force the selling or transfer of shares, assets and liabilities of the failing institution to a public entity designed for that purpose

##### Asset separation tool

The RA can force the selling or transfer of shares, assets and liabilities of the failing institution to a public or partially public asset management vehicle designed for that purpose

##### Bail-in tool (below)

##### Government financial stabilisation tool

When applying other resolution tools to the maximum extent practicable is not sufficient to maintain financial stability or protect public interest, the State member could, as a last resort, offer public equity support or take under temporary public ownership

#### Write-down and conversion of capital instruments

Equivalent to bail in, but on Tier 1 and Tier 2 instruments. Not a resolution tool.

Could be used before the point of non-viability (i.e. before the resolution phase, for an early intervention); or together with a resolution action

### BAIL IN

#### Principles

Generally speaking, granting an administrative authority (the “Resolution Authority”) with the power, in case a bank looks likely to fail, to write down or convert capital and debt instruments so as to:

- pass expected losses to existing risk holders
- reduce the liabilities of the bank
- rebuilding the capital base

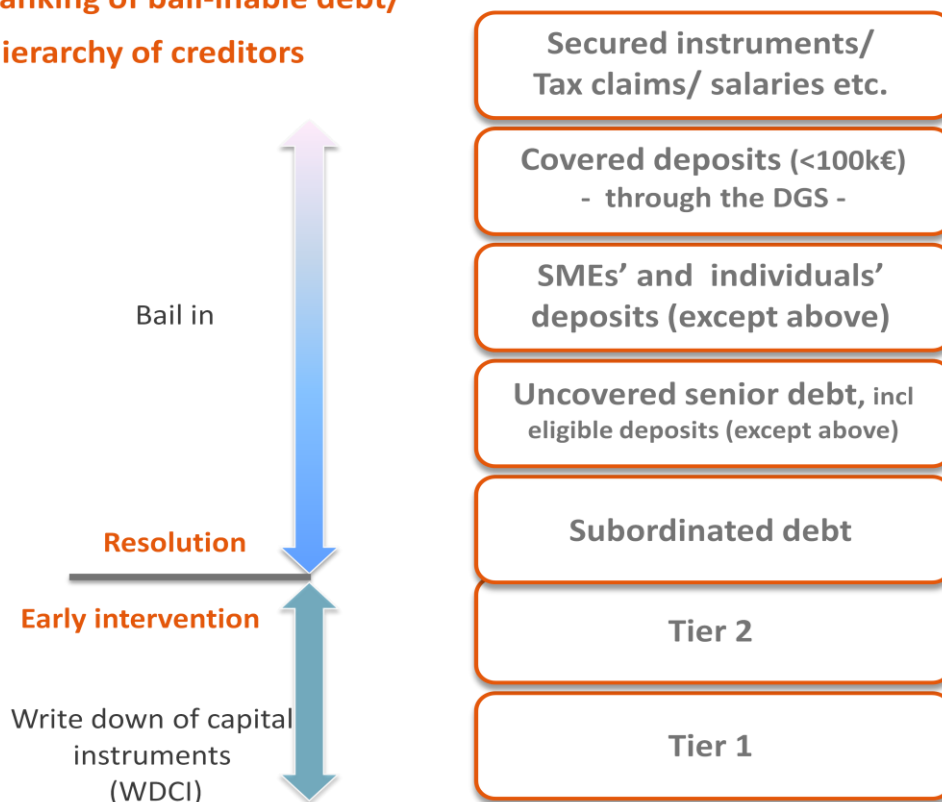
The bail in instrument forces existing shareholders and debt owners to take their share of the restructuring/ resolution costs. It is applied along a precise hierarchy of liability holders (from the most exposed to the institutions losses to the less exposed ones), and in respect with the “no creditor worse off than in liquidation” principle (NCWOL).



In BRRD, the bail-in instrument starts after the implementation of the write down of capital instrument and could be used for:

- recapitalizing an institution so it could be viable again, together with other resolution measures
- or for converting to equity or reducing the liabilities that are transferred to a bridge institution, through the sale of business tool or the asset separation tool

### Ranking of bail-inable debt/ Hierarchy of creditors



### Exclusions from the bail-in scope

Covered deposits (through DGSD) and contributions to DGSs

Secured liabilities (including covered bonds)

Liabilities arising in virtue of the holding of client assets or client money

Interbank operations (except within the group), with an original maturity shorter than 7 days

Liability towards employees, tax administration, critical commercial creditors etc.

### Optional exclusions from the bail-in scope

“In exceptional circumstances”, the RA could exclude:

- liabilities not bail-inable in a reasonable time



- liabilities needed for the continuity of critical functions and key operations
- avoiding widespread contagion, especially for natural persons, SMEs or the functioning of financial markets
- avoiding a destruction of value for other creditors higher than otherwise

### **Optional exclusions: financing principles**

When the RA practices such exclusions, it could increase accordingly the level of write down or conversion of other bail-inable liabilities (while staying compliant with NCWOL principle).

If the RA does not increase accordingly the losses for other bail-inable creditors, and as long as the contribution to loss absorption and recapitalization of the bail-in is higher than 8% of the total liabilities of the bank (including own funds), then:

- the resolution fund could make a contribution to restore the net value of the bank to zero or to capitalize up to 5% of total liabilities (including own funds)...
- In “exceptional circumstances”, after the resolution fund has financed the 5% above, and as long as all unsecured non preferred liabilities other than eligible deposits have been written down or converted in full, the RA could seek “alternative financing” (i.e. state resources)

To finance this up to 5% contribution, the resolution fund could use:

- its existing (ex ante resources) – art 94
- ex post contributions – art 95
- then, alternative financing means (i.e. borrowed money) – art 96

### **Optional exclusions: exceptions to the financing principles**

If the resolution fund’s ex ante resources (article 94) have not been depleted after the financing of the 5% contribution, the remaining ex ante resources of the fund could be the source or a part of the “alternative financing”

Notwithstanding the 8% limit above, the RA could contribute to the resolution financing as long as the contribution to loss absorption and recapitalization of the bail-in is higher than 20% of the risk weighted assets of the bank and the resolution fund resources are larger than 3% of covered deposits in the country as a whole and the failing institution’s assets are below a €900 billion threshold

### **Optional exclusions: EU process**

The optional exclusions of the bail-in scope should be notified to the European Commission

In case financing is sought for from the resolution fund or from alternative financing sources, the Commission has a right to prohibit or amend the exclusions of the bail-in scope, especially if the integrity of the Single Market is put at risk



### **Minimum Requirement for own funds and Eligible Liabilities (“MREL”)**

Own funds and eligible liabilities as a percentage of own funds and total liabilities

Determined by the RA for each individual institution

Should take into account:

- that some bail-inable liabilities could be excluded from the bail in in the end
- the systemicity and interconnectedness with the rest of the financial sector

Eligible liabilities for the MREL are not the same than for the bail-in scope

### **Scope of MREL compared to the scope of bail in + write down of capital instruments (WDCI)**

- remaining maturity of at least one year
- deposits with no depositor preference
- the purchase should not be funded by the institution
- may include instruments issued under the law of a third country, if the institution demonstrates that the bail in by the RA could be applied
- may include qualifying contractual bail-in instruments

## **RESOLUTION FINANCING**

### **Shareholders**

early intervention – recovery plans (WDCI)

### **Bail-inable creditors**

In resolution

### **DGSS**

In lieu of covered deposits and up to the net losses they would have to bear in case of liquidation, and up to 50% of their target level, in case of:

- virtual bail-in on covered deposits
- use of other resolution tools

### **Public support**

Contribution to bail-in, but only **after** the “8%”, after the “5%” and **after** all unsecured non preferred liabilities other than eligible deposits have been written down or converted in full

Governmental financial stabilisation tools (public support equity tool/ temporary public ownership tool), after the other resolution tools have been applied up to the maximum practicable extent (**i.e. after the 8%**)

Notwithstanding those constraints, an **extraordinary public financial support is still possible** (but within EU state aid rules), before the failure of the bank, under the forms stated in article 27-2: state guarantee of newly issued liabilities or to back facilities provided by a central bank, injection of new funds at market conditions



### **Financing arrangements (i.e. resolution funds)**

Contribution to bail-in, after the “8%”

Guarantees, loans, contributions, purchases for:

- the failing institution (when exclusion of certain creditors from the bail-in scope)
- the bridge bank
- the asset management vehicle
- the purchaser (in the context of the sale of business tool)

**Caveat 1:** no transfer of losses to the resolution fund, no recapitalization by the resolution fund

**Caveat 2:** if the actions above result in a transfer of losses to the resolution fund, then the principles set out for the bail-in instrument should apply (**i.e. after the 8%**)

## **CONTRIBUTIONS TO FINANCING ARRANGEMENTS**

### **Financing Arrangements’ financing**

Contributions at least annual, levied on a risk based system.

Target level at 1% of covered deposits before 2025 (+ 4 additional years if the FA had to disburse more than 0.5% of covered deposits)

Contributions to resolution/ systemic failures schemes raised from June 2010 (but not contributions to DGSSs) could be accounted for in the target level

30% max of payment commitments in total available financial means

Extraordinary contributions up to 3 times the annual contribution

Six years replenishment period when the available financial means fall below 2/3 of the target level

Alternative funding arrangements should be in place for short term funding

## **CONTRIBUTIONS TO DGSS, BRRD FINANCING ARRANGEMENTS AND SRM**



	<b>Deposit Guarantee Funds (DGSD)</b> <i>Trilogue concluded</i>	<b>Resolution funds - RFs (BRRD)</b> <i>Trilogue concluded</i>	<b>Single resolution fund (SRM)</b> <i>Trilogue concluded</i>
<b>Total amount</b>			
Reference base	Covered deposits	Covered deposits	Covered deposits
Reference geog. area	Country	Country	SRM zone (= SSM)
Target level	0.8% (0,5% possible)	1%	1%
<b>Individual breakdown</b>			
Base for contribution	Covered deposits	Total liabilities less own funds and covered deposits	Total liabilities less own funds and covered deposits
Reference geog. area	Country	Country	SRM zone (= SSM)