




The EU recovery and resolution directive – Bail-In

Gioacchino Foti

Milan 10 October 2013

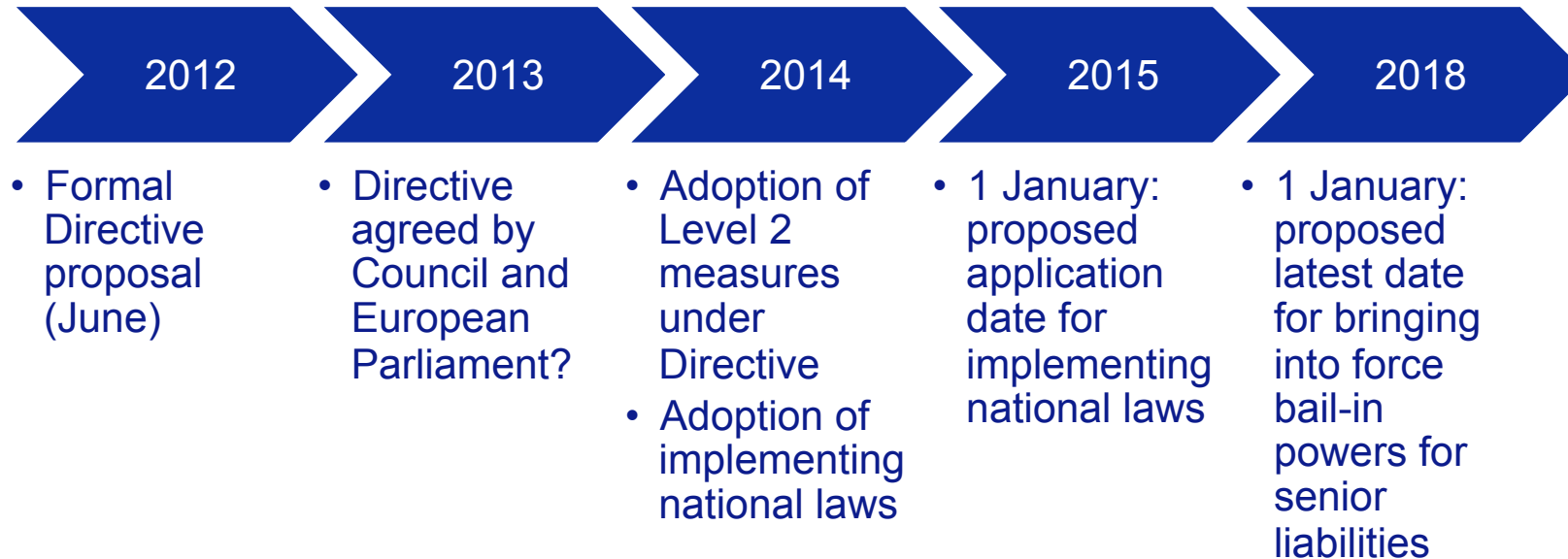
C L I F F O R D
C H A N C E



The objective of an effective resolution regime is to make feasible the resolution of financial institutions without severe systemic disruption and without exposing taxpayers to loss, while protecting vital economic functions through mechanisms which make it possible for shareholders and unsecured and uninsured creditors to absorb losses in a manner that respects the hierarchy of claims in liquidation.

Financial Stability Board, Key Attributes of Effective Resolution Regimes for Financial Institutions (Oct 2011)

Directive Timeline



Conditions for Resolution/Trigger

- Institution failing or likely to fail;
- No reasonable prospect of other actions preventing failure; and
- Resolution in public interest (additional requirements apply for resolution of financial institutions and holding companies)

- Institution failing or likely to fail if:
 - Breach of capital requirements because losses depleting all or substantially all own funds*;
 - Assets less than liabilities*;
 - Unable to pay debts as fall due*; or
 - Requires extraordinary public financial support

**(or objective elements to support determination that this will be case in near future)*



Objectives and principles

Objectives

- Avoid significant adverse effects on financial stability
- Protect public funds
- Protect depositors and investors
- Protect client funds and assets

Principles

- Shareholders bear first losses
- Creditors bear losses after shareholders in order of priority of claims
- Senior management is generally replaced
- Senior management are made liable for their individual responsibility
- Except where provided, creditors of same class treated equitably
- No creditor incurs greater loss than in insolvency proceedings
- Seek to minimise costs of resolution
- Ensure the continuity of critical functions



Resolution Tools

Sale of business

- Transfer of shares or all/part of assets/liabilities to purchaser on commercial terms

Bridge institution

- Transfer of all/part of assets/liabilities to a bridge institution
- Bridge controlled by public authorities, aim to sell within two years

Asset separation

- Transfer of all/part of assets/liabilities to asset management vehicle
- Aim to maximise value by sale or orderly wind down
- Can only be used with other tools

Bail-in

- Power to write-down eligible liabilities (or convert to shares) to (re) capitalise an institution or bridge institution
- Mandatory write down of capital instruments

Additional tools at Member State discretion:

If do not obstruct effective group resolution and consistent with resolution objectives/principles

What is Bail-In

- **Bail-in**
 - **write down the claims of creditors or convert debt to equity**
- **Bail-in tool may be applied**
 - **to recapitalise an institution which meets the conditions for resolution**
 - **to convert to equity or reduce the principal amount of claims or instruments that are transferred to a bridge institution**
- **Bail-in tool may be applied to all liabilities other than**
 - **deposits guaranteed by government guarantee schemes**
 - **secured liabilities**
 - **liabilities arising through holding client assets**
 - **liabilities with maturity of less than one month**
 - **employee liabilities, trade creditors, liabilities for tax and social security**

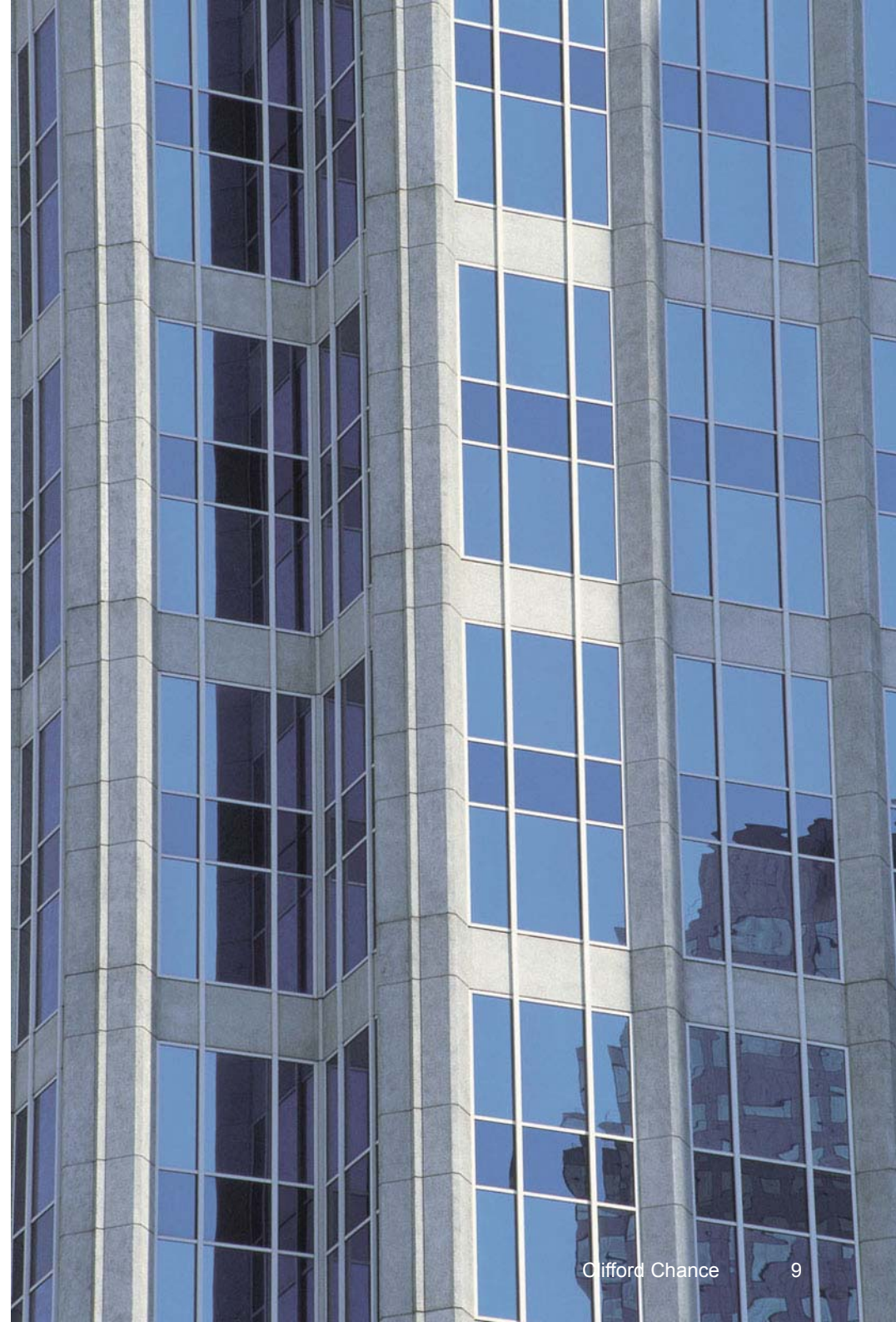


Bail-In Proposals

- 6 January 2011 Commission issued proposal in relation to debt write down
- 13 January 2011 Basel committee proposal for non-common tier 1 and tier 2 instruments and non-viability triggers
- 13 January 2011 press release requires a contractual provision from 1 January 2013 unless there is a viable resolution regime
- Recovery and Resolution Directive (Draft)
- Capital Requirements Regulation

The Bail-In tool

- Contractual vs. Statutory Bail-In
- Tier 1 and Tier 2
- Application of the minimum requirement
- Minimum requirement met through contractual bail-in instruments
- Exclusion of senior bonds?



Contacts



Gioacchino Foti

Counsel Finance &
Capital Markets, Milan

T: +39 02 806 34 335

M: +39 3478688633

E: gioacchino.foti@cliffordchance.com