

## **Note on bank resolution and bail-in**

On 1 January 2017 the European Bank Recovery and Resolution Directive ("BRRD") and the European Regulation establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund ("SRM Regulation") entered into force. They were introduced to provide a uniform framework for all Member States within the European Union for the prevention of banking crisis and the management of distressed banks.

The BRRD was implemented in Austria via the Federal Act on the Recovery and Resolution of Banks (BaSAG). The BRRD inter alia requires each EU member state to establish a national resolution authority with certain rights for the recovery and resolution of credit institutions. The details of the measures the resolution authorities may take on a national level may differ. Below, we explain possible resolution measures that may be applied in Austria as an example. Resolution procedures in other countries, in particular outside Europe, may deviate and be more incisive.

### **In which case will I be affected?**

You may be affected as a shareholder or creditor of a bank if you hold financial instruments issued by the bank (e.g. shares, bonds or certificates) or have claims against the bank as a contracting party (e.g. transactions subject to a master agreement for financial derivatives transactions).

Securities, held in a custody account and not issued by the custodian bank, are not subject to a resolution measure against this bank. In the case of the resolution of a custodian bank, your proprietary rights in these financial instruments booked in the securities account remain unaffected.

### **Who is the resolution authority?**

In order to ensure a controlled resolution in the event of a crisis, resolution authorities have been established. The Single Resolution Board ("SRB", German "Einheitlicher Abwicklungsausschuss") and the Austrian Financial Market Authority (FMA) are the responsible resolution authorities in Austria. For ease of reference, we will not differentiate between the SRB and the FMA in the following. Under certain resolution conditions, the resolution authority responsible for the affected bank has the power to order resolution measures.

### **When will bank resolution and bail-in occur?**

The resolution authority may order certain resolution measures in the event of the following resolution conditions:

- The affected bank's existence is endangered. This assessment is made in accordance with legal requirements and applies if the bank no longer complies with the legal requirements for obtaining authorisation for the taking up of the business of credit institutions due to losses suffered.

- There is no prospect of preventing the bank's default with alternative measures in the private sector or other measures from the resolution authorities.
- The measure is required in the public interest, i.e. necessary and proportionate, and liquidation in regular insolvency proceedings is no viable alternative.
- The resolution authority decides on a case-by-case basis whether the resolution measure is in the public interest, based on the criteria provided for in the law (including avoiding negative effects on financial stability, protecting depositors, and protecting public funds).
- If the resolution authority decides against resolution measures, supervisory proceedings will be initiated against the bank if its insolvency or over-indebtedness is deemed resolvable. This procedure means that you can only assert your unsecured claims against the bank in question after the insolvency or over-indebtedness has been resolved.
- If it is deemed irreversible that the bank's over-indebtedness or insolvency cannot be remedied, bankruptcy proceedings will be initiated against the bank's assets. In bankruptcy proceedings, you will only receive the bankruptcy dividend attributable to your claim on the financial instrument you hold that was issued by the bank. If the claim is secured by collateral (e.g., in the form of a cover pool), you are entitled to priority satisfaction from this collateral.

### **Which measures may the resolution authority take?**

If all resolution conditions are met, the resolution authority can adopt – prior to insolvency – comprehensive resolution measures that may have a negative effect on the bank's shareholders and creditors:

- The sale of business tool: The resolution authority may transfer shares, assets, rights or liabilities of the failing institution as a whole or in parts to a third party. To the extent shareholders and creditors are affected by the sale of business, their new counterparty will be another existing institution.
- The bridge institution tool: The resolution authority may transfer shares in the bank or parts or the whole of the bank's assets or liabilities to a so-called bridge institution. This may affect the bank's capability to meet its payment and delivery obligations vis-à-vis the creditors and it may reduce the value of shares in the bank.
- The asset separation tool: Assets, rights or liabilities are transferred to an asset management vehicle. Assets are to be managed with the objective of maximizing their value until their future sale or liquidation. Similar to the sale of business tool, the creditor will have to deal with a new debtor after the transfer.
- The bail-in tool: The resolution authority may, as a whole or in parts, write down and/or convert into common equity (stocks or other company shares) certain financial instruments or liabilities of the bank in order to stabilise the bank.

The resolution authority may amend the terms and conditions of financial instruments issued by the bank by means of an official order as well as existing receivables, for example due to a change in the maturity date or the interest rates at the expense of the creditor. Furthermore, payment and delivery obligations may be modified so that they can be temporarily suspended. Termination and other contractual rights that arise for creditors from financial instruments or liabilities may also be temporarily suspended.

### **In which case does bail-in affect me as a creditor?**

Whether you as a creditor are affected by the bail-in resolution tool depends on the scope of the ordered measure and on the category your financial instrument or liability can be allocated to.

Certain types of financial instruments and liabilities are legally exempted from bail-in:

These include deposits of up to EUR 100,000 covered by the statutory deposit protection scheme and secured liabilities (e.g. covered bonds).

Within the scope of bail-in, financial instruments and liabilities are distinguished in different categories depending on a legal order of priorities in terms of liability (so-called liability cascade).

For the shareholders and creditors involved in the respective categories, the following principles apply:

Only if a category of liabilities has been used completely and this is insufficient to compensate for losses in order to stabilise the bank, the following category in the liability cascade may be written down or converted.

1. The resolution measures first apply to the Common Equity Tier 1 capital and thus the bank's shareholders (owners of stocks and other company shares).
2. Then, creditors of Additional Tier 1 capital are involved (owners of unsecured perpetual subordinated bonds and silent partnerships that may be written down or converted and are subordinated to Tier 2 capital).
3. This is followed by Tier 2 capital. This applies to creditors of subordinated liabilities (e.g. owners of subordinated loans).
4. In the liability cascade, unsecured subordinated) financial instruments / liabilities that do not meet the Additional Tier 1 capital or Tier 2 capital requirements are the next to be used.
5. These are followed by unsecured unsubordinated financial instruments and liabilities (other unsecured financial instruments / liabilities, such as senior bonds).
6. Finally, deposits held by natural persons or small and medium size enterprises may also be used if they exceed the statutory deposit protection scheme of generally EUR 100,000 (Österreichische Raiffeisen-Sicherungseinrichtung eGen).

## **Which consequences may the resolution measures have for me as a creditor?**

If the resolution authority orders or takes a measure following these rules, creditors are not permitted to terminate the financial instruments and liabilities based on this measure alone or claim any other contractual rights.

This applies as long as the bank complies with its substantive contractual obligations from the terms and conditions of financial instruments and liabilities, including payment and delivery obligations.

If the resolution authority takes the measures described above, a total loss of affected shareholders' and creditors' investment is possible.

Shareholders and creditors of financial instruments and liabilities may therefore completely lose the price paid for the purchase of financial instruments and liabilities plus other costs related to the purchase.

The very possibility of resolution measures to be ordered alone may complicate the sale of a financial instrument or a liability on the secondary market. This could mean that the shareholder and creditor can only sell the financial instrument or liability at a considerable discount. Even with existing repurchase obligations from the issuing bank, there is the risk of a significant discount in the event of a sale of such financial instruments.

In the event of bank resolution, shareholders and creditors are not to be placed in a less favourable position than in normal insolvency proceedings affecting the bank.

If resolution measures nonetheless lead to a situation where a shareholder or creditor is placed in a worse position than would have been the case in the bank's normal insolvency proceedings, the shareholder or creditor is entitled to compensation.

## **Where can I get more information?**

The Austrian National Bank and the Austrian Financial Market Authority published information on the recovery and resolution rules applicable in Austria:

Austrian National Bank: Recovery and Resolution of Banks  
[www.oenb.at/finanzmarkt/die-bankenunion/einheitlicher-abwicklungsmechanismus.html](http://www.oenb.at/finanzmarkt/die-bankenunion/einheitlicher-abwicklungsmechanismus.html)

Austrian Financial Market Authority: Recovery and Resolution  
[www.fma.gv.at/abwicklung-allgemein/](http://www.fma.gv.at/abwicklung-allgemein/)