

## Box 10

## FORTHCOMING IMPLEMENTATION OF THE BAIL-IN TOOL

The forthcoming Bank Recovery and Resolution Directive (BRRD) will introduce a bail-in tool in all Member States by 1 January 2016 at the latest. The bail-in tool will enable resolution authorities to write down or convert into equity the claims of a broad range of creditors in resolution. This tool will be essential to achieve orderly resolution without exposing taxpayers to losses, while ensuring continuity of critical functions to avoid a serious disturbance in the financial system and the economy as a whole.

The order in which creditors, after shareholders, would be affected by a bail-in is the following: subordinated liabilities, unsecured and non-preferred liabilities, and preferred liabilities. Covered deposits are excluded from bail-in, but the deposit guarantee scheme (DGS) would step in and make a contribution for covered deposits (i.e. eligible deposits up to €100,000) if needed. To further protect deposits in insolvency and resolution, a harmonised depositor preference is introduced. Eligible deposits from natural persons and micro, small and medium-sized enterprises will be preferred over unsecured and non-preferred liabilities, while covered deposits will be preferred over all eligible deposits. The DGS will subrogate the preferred ranking of covered deposits in insolvency and resolution cases; thereby the depositor preference will also protect the DGS.

In the BRRD, a few particular types of liabilities, in addition to covered deposits, are excluded from bail-in, e.g. secured liabilities, liabilities in relation to client assets, client money or fiduciary relationships, and certain very short-term (less than seven days) liabilities to other institutions or to financial systems/operators of such systems. All creditors are also protected by the “no-creditor-worse-off” principle, i.e. they should never face losses in resolution that are higher than they would be subjected to under normal insolvency.

In exceptional circumstances, the BRRD allows resolution authorities to exclude or partially exclude other liabilities if: (i) it is not possible to bail them in within a reasonable time; (ii) it is strictly necessary and proportionate to achieve the continuity of critical functions and core business lines; (iii) it is strictly necessary and proportionate to avoid giving rise to widespread contagion; or (iv) if bailing them in would cause a destruction of value such that the losses borne by other creditors would be higher than if these liabilities were excluded from the bail-in. In order to avoid that this flexibility is casually used to shield creditors from losses, the resolution fund cannot be used, as a general rule, to cover any excluded liabilities until an amount of at least 8% of the total liabilities, including own funds, of a bank have been bailed in. The Commission has the right to object or require amendments if the requirements for such exemptions are not met, provided that the exemption would require a contribution by the SRF or an alternative financing source. The Single Resolution Mechanism will also ensure a consistent application of the bail-in tool in the banking union.

In order to make sure that there are sufficient liabilities to bail in at the point of resolution, the resolution authorities will, in consultation with the supervisors, determine a minimum requirement of eligible liabilities and own funds (MREL) for bail-in for each bank. The MREL will be determined as a percentage of total liabilities and own funds, with which banks must comply. To be eligible, an instrument must be issued and fully paid up, not owed to, secured by or guaranteed by

the institution itself, not be a preferred deposit or a derivative, and have a remaining maturity of at least one year, among other things.

The level and, for bank groups, the locations of the MREL will depend on the resolution strategy developed for the specific bank or group. The resolution authority, after consulting the supervisor, will draw up a plan which provides for the resolution actions to be taken if the bank meets the conditions for resolution. These plans should describe how orderly resolution may be achieved without exposing taxpayers to losses, while ensuring continuity of critical functions. It will be possible to adjust the MREL depending on the structure, size, risk profile and business model of the bank and its degree of resolvability. For most banks in the EU, the work to conduct resolvability assessments, develop resolution plans and determine MREL levels will begin in 2015, when both the BRRD and the Single Resolution Mechanism Regulation will be applicable. However, for the global systemically important banks (G-SIBs) under the G20/Financial Stability Board's agenda to end the too-big-to-fail problem, the work has already started. Currently, work – in which the ECB is participating – is ongoing to develop a proposal on the adequacy, type and location of gone-concern loss-absorbing capacity (GLAC) in resolution for G-SIBs. The GLAC proposal, which would correspond to the MREL in the BRRD, should be ready by the end of the year – in time for the FSB's Brisbane summit in November 2014.