This document is a working document of the services of DG Internal Market and does not prejudge the Commission's formal proposal

Discussion paper on the debt write-down tool – bail-in

Executive Summary

The need for effective resolution

Banks provide vital services to citizens, businesses, and the economy at large (such as deposit-taking, lending, and the operation of payment systems). These institutions operate largely based on trust, and can quickly become unviable if their customers and counterparties lose confidence in their ability to meet their obligations. Because of the vital role played by banks, and in the absence of effective resolution regimes, authorities have often had to put up taxpayers' money to restore trust and avoid a domino effect of failing banks from seriously damaging the real economy.

In October 2010 the Commission issued a Communication[1] setting out plans for an EU framework for crisis management in the financial sector. The aim of the framework is to equip authorities with common and effective tools and powers to tackle bank crises at the earliest possible moment, and avoid costs for taxpayers. In this Communication the Commission stated that "In spite of the technical challenges presented by the design of a debt write-down mechanism, the Commission considers that it offers an additional resolution tool that would significantly enhance the ability of authorities to resolve large and complex financial institutions"[2]. The Commission services published a consultation document in January 2011[3], where, amongst others, they proposed and sought views on the design of a debt write-down mechanism, as an additional tool to the standard resolution tools (such as transfer of business to a private sector entity or bridge bank, or a 'good bank/bad bank' split). The Commission services have further developed the design of this tool and consider it helpful, before finalising the text, to have a technical discussion with the main stakeholders and experts on the details and calibration of this tool.

Rather than relying on taxpayers, a mechanism is needed to stop the contagion to other banks and cut the possible domino effect. It should allow public authorities to spread unmanageable losses on banks' shareholders and creditors.

Resolution is an essential complement to other measures designed to make banks safer and less likely to fail, such as requirements for more and better-quality capital (the proposed Capital Requirements Directive IV implementing the Basel III accord[4], additional loss-absorbency requirements for the largest banks (systemically important financial institutions, SIFIs), and the

1 COM (2010) 579 final
2 See Communication COM (2010)579 final, page 12.
3 http://ec.europa.eu/internal_market/consultations/2011/crisis_management_en.htm
4 "New proposals on capital requirements," 20 July 2011 http://ec.europa.eu/internal_market/bank/regcapital/index_en.htm#crd4

examination into possible structural steps to address weaknesses in banks' business models (the recently created high-level group on structural banking reform[5]).

In essence a resolution framework is an expeditious way of dealing with banks in difficulty so as to avoid them from causing a systemic event. In most countries, bank and non-bank companies in financial difficulties are subject to "insolvency" proceedings. These proceedings allow either for the reorganization of the company (which implies a reduction, agreed with the creditors, of its debt burden) or its liquidation and allocation of the losses to the creditors, or both. In all the cases creditors and shareholders do not get paid in full.

However, the experience from the different banking crises (see for example the case of Lehman) indicates that insolvency laws are not apt to deal efficiently with the failure of financial institutions. They do not appropriately consider the need to avoid disruptions to financial stability, maintain essential services or protect depositors. In addition, insolvency proceedings are lengthy and in the case of reorganization, they require complex negotiations and agreements with creditors, with some potential detriment for the debtors and the creditors in terms of delay, costs and outcome.

Therefore, authorities need a resolution regime that replaces – when necessary - normal insolvency proceedings for banks, safeguards financial stability, and protects taxpayers. The regime should enable authorities to take control of the situation and proceed with a managed reorganization or a managed total or partial wind down of the entity facing imminent failure, as the case may be.

An effective resolution regime should:

- Achieve, for banks, similar results to those of normal insolvency proceedings, in terms of allocation of losses to shareholders and creditors
- Shield as much as possible any negative effect on financial stability and limit the recourse to taxpayers' money
- Ensure legal certainty, transparency and predictability as to the treatment that shareholders and creditors will receive, so as to provide clarity to investors to enable them to assess the risk associated with their investments and make informed investment decisions prior to insolvency.

The European resolution framework that the Commission services intend to propose will include elements for prevention (such as resolution and recovery plans) as well as for early intervention and resolution. In particular it will provide resolution authorities with a toolkit consisting in a series of powers and tools (such as the bridge bank, the sale of business, the asset separation, etc.) that would allow them to deal with banks in difficulties. One of those tools could be the debt write down tool or bail-in. When the resolution authorities would have to confront a bank failure they would be empowered to use one or a combination of the tools, as considered necessary, in order to achieve the objective of resolving the entity without causing major economic disruption. In this respect the authorities will have to decide as to whether the best solution would be to restructure the entity as a going concern (through bail-in), to restructure it as a gone concern (i.e. through a bridge bank or a combination of bridge bank and bail-in) or to wind it down in full or in part. The resolution framework should cater for all those alternatives.

[5] http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/12/129&format=HTML&aged=0&language=EN&guiLanguage=en

The bail-in tool

The debt write down tool is a tool by which Resolution authorities could be given a statutory power, exercisable when an institution meets the trigger conditions for entry into resolution, to write off all equity, and either write off subordinated liabilities or convert it into an equity claim. The debt write down tool can be used both in a going concern scenario and a liquidation scenario. In a going concern scenario, bail-in would be used to absorb losses and recapitalise the entity. The entity would be then restructured and maintained as a going concern. In a liquidation scenario, bail-in would be used to wind down the entity.

As mentioned above, one of the features of reorganization or wind down under insolvency law is that <u>shareholders and creditors bear losses</u>. This should also be the case in a resolution regime. But this cannot always be done relying only on consensus or on the agreement of the majority of creditors. In view of the critical intermediary role that banks play in our economies, financial difficulties in banks need to be resolved in an orderly, quick and efficient manner, avoiding undue disruption to the bank's activity and to the rest of the financial system and minimizing the cost and length of the proceedings. This is why we need legal mechanisms that allow identifying and imposing losses on shareholders and creditors without delay. One of the mechanisms that could serve this purpose is the debt write-down tool or "bail-in".

<u>The introduction of bail in could provide authorities with a resolution option, in particular for the resolution of large and complex institutions. In such cases, the application of other resolution tools (such as the sale of the bank to a private sector purchaser or the splitting of the bank into a good bank/bad bank) might prove particularly challenging given the need to act swiftly.</u>

The bail-in tool, if correctly designed and applied, would result in an allocation of losses that would not be worse than the losses that shareholders and creditors would have suffered in "normal" insolvency proceedings. Like in insolvency law, also in the resolution regime, the authority should be able to reorganize the entity as a going concern or to totally or partially wind it down. When the entity has a reasonable prospect of survival, it will be consistent with the objective of maximizing the value of the viable entity and of reassuring markets to allow the bank to continue its activity whilst restructuring its debts and reorganizing its business.

This will be of <u>greater benefit in the long term for both the creditors and the rest of the financial system</u> than liquidating the bank. In some cases it might be more justified to liquidate all or part of the entity. The bail-in tool could allow authorities to speedily allocate losses either through the reorganization of the bank as a going concern or in the full or partial wind down of the bank.

<u>Bail-in could thus bring a number of benefits to public finances, the financial system, the entities in difficulty and their creditors.</u> According to the Commission services' back testing analysis and calculations, the bail-in tool would have been helpful in minimizing the impact of the current crisis on public finances. However, the short-term impact of the bail-in tool on banks' access to market funding, in particular in times of financial stress, has not yet been tested and therefore, additional measures such as liquidity support from the central bank cannot be excluded.

Calibration of the bail-in tool

<u>The effectiveness of the bail-in tool depends on the design of the regime.</u> In the Commission services' view, it is important that:

- The bail-in respects as far as possible the ranking of creditors' claims under insolvency law;
- Legal certainty is given to investors as to when and under which conditions their claims would be converted to equity or written down;
- Banks have sufficient "bail-in-able" liabilities (see Section 5 – Minimum requirement for eligible liabilities);
- There is a clear obligation that the ultimate goals of the tool for financial stability (such as the reorganization of the entity or its orderly wind down) are achieved;
- The broader impact of bail-in on the market, in particular on the cost of funding for banks is minimized, and
- The impact on the internal market and divergent national implementations should be minimized.

These various objectives should be balanced in order to achieve an efficient and practicable bail-in system.

According to the provisional assessment carried out by the Commission services, the parameters which could achieve the objectives above are the following.

<u>In order to underpin legal certainty and respect as far as possible the ranking of claims in insolvency:</u>

a) The point of entry into resolution should be close to insolvency (see Section 1 – Point of entry into resolution);
b) Bail-in would include in principle all the liabilities, except those whose inclusion could have a detrimental effect on financial stability or those that are essentially client related;
c) No creditor should be worse off than if the bank went into insolvency.

<u>In order to maintain financial stability, limit the increase in the cost of funding and ensure predictability for investors:</u>

a) It would establish a clear hierarchy by which equity, equity like liabilities and subordinated liabilities would be bailed in first; and

b) It could exclude short term liabilities and establish a clear principle that all non-excluded liabilities would be treated pari-passu (after those under (a)), or

c) Alternatively to (b), it could establish a specific hierarchy between the different bail-in-able liabilities (after those under (a)). This hierarchy could be based on the maturity of the instrument in the sense that those instruments with a maturity of more than one year would be bailed in before those with a maturity of less than one year.

<u>In order not to subvert the funding mix, to ensure sufficient bail- inable liabilities and to limit the potential cost of bail-in:</u>

It could establish a minimum requirement for liabilities of more than one year. This minimum requirement could:

a) Be a concrete requirement. Together with capital, eligible liabilities would have to reach a target level of 10% of total liabilities, or

b) Consist on an obligation for the resolution authorities to fix a minimum level on a case by case basis.

1. – Point of entry into resolution

If introduced, the debt write-down tool would give resolution authorities the power to write down the claims of unsecured creditors of a failing institution and to convert debt claims to equity. The debt write-down tool would be at the disposal of the authorities, together with the other resolution tools, at the moment when an institution meets the conditions for entry into resolution. The conditions for exercising the bail- in power could be the same as the ones for the other resolution tools. The point of entry into resolution would be when the institution is failing or likely to fail. This means that it would be a point close to insolvency, but earlier than the criteria (such as cessation of payments) for commencement of normal insolvency proceedings, due to the specificities of banks. Below is a description of what could be the point of entry into resolution.

Main features of the regime

Resolution authorities could take a resolution action in relation to an institution or a parent undertaking only if all of the following conditions are met:

(a) the competent authority or resolution authority determines that the institution or the parent undertaking is failing or likely to fail;

(b) having regard to timing and other relevant circumstances, there is no reasonable prospect that any alternative private sector or supervisory action, including an agreement with the creditors to restructure all or part of its debt, other than a resolution action taken in respect of the institution or the parent undertaking, would prevent the failure of the institution within reasonable timeframe;

(c) a resolution action is necessary in the public interest.

An institution or a parent undertaking is failing or likely to fail if one or more of the following circumstances would apply:

(a) that the institution or the parent undertaking is in breach or there are objective elements to support a determination that the institution or the parent undertaking will be in breach, in the near future, of the capital requirements for continuing authorisation in a way that would justify the withdrawal of the authorisation by the competent authority because the institution has incurred or is likely to incur in losses that will deplete all or substantially all of its own funds;

(b) that the assets of the institution or the parent undertaking are or there are objective elements to support a determination that the assets of the institution or the parent undertaking will be, in the near future, less than its liabilities;

(c) that the institution or the parent undertaking is or there are objective elements to support a determination that the institution or the parent undertaking will be, in the near future, unable to pay its obligations as they fall due;

(d) the institution or the parent undertaking requires extraordinary public financial support[6].

A resolution action should be treated as in the public interest if it achieves and is proportionate to one or more of the resolution objectives[7] and winding up of the institution or parent undertaking under normal insolvency proceedings would not meet those resolution objectives to the same extent.

Question box 1

1. *Do you consider that the point of entry into resolution should be the same as the one for the rest of the resolution tools? Do you consider that it should be a point close to insolvency?*

2.- Purpose of the debt write-down tool

The debt write-down tool could be available both in an open bank and a closed bank scenario. In both cases, it should not amount to bailing out existing shareholders. Resolution authorities should be entitled to write down and convert creditors' claims either for the purpose of capitalising a bridge bank (closed bank) or recapitalising the institution that has been declared under resolution (open bank).

The difference between the two models of bail-in is the following:

Open bank model: the bank would be maintained as a going concern, using the money from the shareholders and creditors to absorb losses. Shares would be written down first, as they are the first instruments to absorb losses. Subsequently liabilities are converted into equity in order to absorb losses and recapitalize the bank.

Closed bank model: the bank would be split in two: good bank or bridge bank and the bad bank. The good bank-bridge bank would be a newly created legal entity which continues to operate; the old bad bank is liquidated. Bank creditors could either be left with the old bank, and participate in the liquidation, or be transferred to the new bank either reducing their credits or converting their credits into equity.

<u>Main features of the regime</u>

The resolution authorities could apply the debt write-down tool for either of the following purposes:

[6] The assumption is that bail in should come before any extraordinary public financial support

[7] The resolution objectives could be: to ensure the continuity of critical functions; to avoid significant adverse effects on financial stability, including by preventing contagion and maintaining market discipline; to protect public funds by minimising reliance on public support; to avoid unnecessary destruction of value and to seek to minimise the cost of resolution; to protect depositors covered by Directive 94/19/EC and investors covered by Directive 97/9/EC, and to protect client funds and client assets.

(a) to recapitalise an institution that meets the conditions for resolution to the extent sufficient to restore its ability to comply with the conditions for authorisation and to carry on the activities for which it is authorised under Directive 2006/48/EC or Directive 2004/39/EC;

(b) to convert to equity or reduce the principal amount of claims or debt instruments that are transferred to a bridge institution with a view to providing capital for that bridge institution.

The resolution authorities could apply the debt write-down tool for the purpose mentioned in (a) only if there is a realistic prospect that the application of that tool, in conjunction with measures implemented in accordance with the business reorganisation plan will, in addition to achieving relevant resolution objectives, restore the institution in question to financial soundness and long-term viability.

Question box 2

2. *Do you consider that a credible framework for the resolution of banks should include both the open bank and the closed bank bail-in?*

3.- Scope of the debt write-down tool

The legal framework needs to be clear and precise as to which liabilities would be subject to the debt write-down power. It is considered that a broad scope is preferable to make the tool efficient and avoid any circumvention. In this respect exclusions should be strictly limited to those liabilities that are necessary to ensure the proper functioning of credit markets or to underpin financial stability. In order to ensure the continuous operation of the bank, it could be useful to exclude from the scope liabilities with a very short maturity (i.e. with a maturity of less than 1 month) that could be subject to extreme volatility in the case that the institution is approaching the point of non viability. Other short term liabilities (with a maturity between 1 month and 1 year) would be included in the scope, but would be subjected to write down only after long term liabilities under option 2 (see Section 4 - Implementation of debt write-down: hierarchy of claims).

Special attention should be paid to the possible write-down of covered deposits. Although covered deposits would be excluded from the scope of bail-in, it is considered that, in order to underpin the effectiveness of the tool, it would be useful that Deposit Guarantee Schemes (DGS) are treated pari passu to all other creditors that could be subject to the write-down and conversion (unless they are granted a preferential treatment under national insolvency laws). Taking into account that covered deposits represent an important part of the liabilities of credit institutions the implications of including the Schemes in the debt write-down tool would minimise the effect of the tool on the other creditors included. This would not be contrary to the main purpose of the DGS which is to ensure the continuous availability of deposits. The fact that a credit institution is bailed in would ensure that deposit holders will have continuous and unrestricted access to their funds in an institution that will be restored to viability and properly restructured. This means that the Deposit Guarantee Schemes' legal framework should be modified to establish sufficient safeguards to ensure that the use of funds under a resolution scenario do not imply a depletion of those *funds in view of any possible future intervention*[8]*. In the case of the use of the DGS in a closed bank scenario, it would also imply a modification of the Deposit Guarantee Scheme Legal framework so that the money from the DGS could be used, if necessary, to finance the transfer of the covered deposits to the bridge institution and consequently to absorb losses that would have been allocated to depositors*[9]*.*

Liabilities originated on derivatives exposures should also, in principle, be included in the scope of the tool. However, the effective application of the tool to those exposures is not as legally straightforward as for other types of liabilities and it may raise some concerns in terms of financial stability. On the other hand, an exclusion of such an important part of the liabilities of those institutions that could be subject to the debt write-down tool (the systemically important ones which are the most active in the derivatives markets) might deprive the tool of part of its effectiveness.

The case has not been made to exclude secured liabilities in those cases where the collateral does not fully cover the totality of the liability. Allowing for a complete exemption of those liabilities would be unfair to the other creditors. This will of course not be the case if under national insolvency law the encumbered claims have been granted a preferential treatment also with respect to the rest of the insolvency estate or when community law or national insolvency law provides for a segregation of the secured liabilities together with the security attached whilst no residual claim over the remaining institution is maintained. In these cases it might be foreseeable to completely exclude those liabilities from the scope of the bail-in.

<u>Main features of the regime</u>

The debt write-down tool would be applied to all liabilities of an institution that are not excluded from the scope of that tool.

Resolution authorities should not exercise the write-down and conversion powers in relation to the following liabilities:

(a) secured liabilities[10],

(b) liabilities that are secured by collateral, including liabilities arising from repurchase transactions ('repos') and other title transfer collateral arrangements;

(c) deposits that are guaranteed in accordance with Directive 94/19/EC;

(d) short-term liabilities with an original maturity of less than one month

(e) any liability that arises by virtue of the holding by the institution of client assets or client money, or a fiduciary relationship between the institution (as fiduciary) and another person (as beneficiary);

[8] This is currently being discussed in the framework of the negotiations of the DGS proposal. In this respect it would be important to highlight the obligation to immediately provide funds to the Schemes in case depositors need to be reimbursed.

[9] This possibility is currently being discussed in the framework of the negotiations of the DGS proposal.

[10] 'secured liability' means a liability where the right of the creditor to payment is secured by a charge over assets, a pledge or lien, or collateral arrangements.

(f) a liability to any one of the following:

(1) an employee, in relation to accrued salary, pension benefits or other fixed remuneration, except for variable remuneration under any form;

(2) a commercial or trade creditor arising from the provision to the institution of goods or services that are essential to the daily functioning of its operations, including IT services, utilities and the rental, servicing and upkeep of premises;

(3) tax and social security authorities, provided that those liabilities are preferred under the applicable insolvency law.

Points (a) and (b) should not prevent resolution authorities, where it is appropriate to do so, from exercising those powers in relation to any part of a secured liability or a liability for which collateral has been pledged that exceeds the value of the assets, pledge, lien or collateral against which it is secured.

Point (c) should not prevent resolution authorities, where it is appropriate to do so, from exercising those powers in relation to any amount of a deposit that exceeds the coverage under that Directive.

Notwithstanding (c), when the resolution authority exercises the write-down and conversion powers the Deposit Guarantee Scheme should be liable, up to the covered amount, for the amount by which the write-down and conversion would have been applied to the deposits under (c). Such amount should be determined as if those deposits were not excluded by virtue of (c).

Question box 3

3a. *Do you agree with the suggested list of excluded liabilities?*
3b. *Do you consider that liabilities with an original maturity shorter than a certain period should be excluded from bail-in? Should this period be 1 month, 3months, or another period?*
3c. *Do you consider that derivatives should be included in the scope of bail-in? If not, what would be the reason that would justify granting them a preferential treatment?*
3d. *Do you consider that DGS should be included in the scope of bail-in (i.e. DGS suffers losses instead of covered depositors pari passu with unsecured liabilities)?*
3e. *Do you consider that secured liabilities should be included in the scope of bail-in when the value of the security is lower than that of the liability? Under what conditions do you consider they could be totally excluded without granting them an unjustified preferential treatment?*
3f. *How would it be possible to avoid that financial instruments are designed with the purpose of being excluded from the scope of bail in able liabilities (i.e. bonds with embed options?*

4.- Implementation of debt write-down: hierarchy of claims

In principle, the bail-in should encompass all the debts that would normally not be paid in full in reorganization proceedings. In this respect the question can be raised as to whether all liabilities that are potentially subject to the debt write-down tool (those that are not excluded) should be subject to the haircut and conversion powers in accordance with the hierarchy of claims defined under national insolvency regimes or there could be reasons for modifying that ranking in the case of bail- in.

It seems to be clear from any perspective that equity, equity like and subordinated instruments should be subject to the debt write-down tool before any other bail- inable instrument. As for the rest (non-subordinated, senior debt) there are different possible options. The first option would be basically respectful of the insolvency hierarchy of claims and would treat all the rest of the liabilities in the same way (i.e. senior debt, derivatives, non-excluded deposits, DGS). This means that losses would be allocated to them pro-rata. This is a simple and clear way of dealing with the issue of the allocation of losses. However, being so comprehensive in the implementation of the debt write-down could lead to certain tensions in the capital markets and could increase the cost of funding in a disproportionate way (especially for short term funding and when approaching the point of non viability).

For this reason another option could be a <u>sequential</u> bail-in model. Under the sequential bail-in model long term liabilities would be first to absorb residual losses after equity and equity like instruments; only if they were not sufficient in order to achieve the objectives of the debt write-down tool, the authorities could proceed to apply the tool to short term liabilities. Consistency with the Basel 3 requirements regarding liquidity and funding would need to be ensured.

In relation to derivatives under this sequential option one could consider a distinction between those derivatives that are cleared through a central counterparty (CCP) and those that are not. The latter could be assimilated to the long term liabilities (according to their maturity) whilst the former could be treated as short term liabilities (irrespective of their maturity). This could reflect current policy of promoting CCPs as a means to improve transparency and risk management in derivatives markets.

Those derivatives which are not cleared through a CCP could be subject to bail-in according their maturity. This means that if they have an original maturity of more than 1 year they would be long term liabilities and if they have less they would be short term.

Both the first and the second option are respectful of the need to ensure certainty for creditors and both ensure a broad base for applying bail-in. The main difference between them is that the sequential option establishes a special ranking amongst creditors of the same class on the basis of the maturity of the debt.

In the described scenario Deposit Guarantee Schemes should be written down at the same time as all other bail-inable debts (irrespective of the maturity of the deposits they cover – in the sequential option the DGS would be treated as long term liabilities). If they were not to be bailed in at the same time, the DGS would be granted a privileged position to the detriment of the other unsecured creditors which in turn would make unsecured funding much more expensive[11]. Bailing in the DGS would not have any impact on the depositors themselves who would still be entitled to a continuous access to their funds.

<u>Main features of the regime</u>

<u>Option 1</u>

When applying the debt write-down tool, resolution authorities should exercise the write-down and conversion powers in accordance with the following provisions:

[11] This is, of course, unless Deposit Guarantee Schemes have been granted a preferential treatment under national insolvency laws.

(a) authorities should first reduce to zero the principal amount of Additional Tier 1 instruments that are liabilities and Tier 2 instruments;

(b) if, and only if, the total reduction of liabilities pursuant to point (a) is less than the aggregate amount[12], authorities should reduce the principal amount of subordinated debt that is not Additional Tier 1 or Tier 2 capital to the extent required (in conjunction with the write-down pursuant to point (a)) to produce the aggregate amount;

(c) if, and only if, the total reduction of liabilities pursuant to points (a) and (b) is less than the aggregate amount, authorities should:

– reduce the principal amount of, or outstanding amount payable in respect of, the rest of eligible liabilities that are senior debt to the extent required (in conjunction with the write-down pursuant to points (a) and (b) to produce the aggregate amount and

- require a payment from the Deposit Guarantee Scheme for the amount by which the write down and conversion would have been applied to the deposits if those deposits were not excluded from the scope.

When applying the write-down and conversion powers in compliance with points (b) and (c) resolution authorities should allocate the losses represented by the aggregate amount equally between liabilities of the same rank by reducing the principal amount of, or outstanding amount payable in respect of, those liabilities to the same extent pro rata to their value.

Where an institution has issued instruments, other than those mentioned in (a), that contain either of the following terms:

(a) terms that provide for the principal amount of the instrument to be reduced on the occurrence of any event that refers to the financial situation, solvency or levels of own funds of the institution;

(b) terms that provide for the conversion of the instruments to shares or other instruments of ownership on the occurrence of any such event,

and the terms mentioned in point (a) or point (b) have not taken effect, resolution authorities should reduce the principal amount of the instrument or convert it in accordance with those terms before exercising the write-down and conversion powers to the liabilities mentioned in points (b) and (c).

<u>Option 2</u>

When applying the debt write-down tool, resolution authorities should exercise the write-down and conversion powers in accordance with the following provisions:

(a) authorities should first reduce to zero the principal amount of Additional Tier 1 instruments that are liabilities and Tier 2 instruments;

[12] See section 6(c) below for the discussion on the notion of the "aggregate amount"

(b) if, and only if, the total reduction of liabilities pursuant to point (a) is less than the aggregate amount[13], authorities should reduce the principal amount of subordinated debt that is not Additional Tier 1 or Tier 2 capital to the extent required (in conjunction with the write-down pursuant to point (a)) to produce the aggregate amount;

(c) if, and only if, the total reduction of liabilities pursuant to points (a) and (b) is less than the aggregate amount, authorities should

– reduce the principal amount of, or outstanding amount payable in respect of, eligible liabilities with an original maturity of more than one year (excluding liabilities arising from derivatives cleared through a central counterparty) that are senior debt, and

– require a payment from the Deposit Guarantee Scheme for the amount by which the write down and conversion would have been applied to the deposits if those deposits were not excluded from the scope,

to the extent required (in conjunction with the write-down pursuant to points (a) and (b)) to produce the aggregate amount;

(d) if, and only if, the total reduction of liabilities pursuant to points (a), (b) and (c) is less than the aggregate amount, authorities should reduce the principal amount of, or outstanding amount payable in respect of, the rest of eligible liabilities that are senior debt to the extent required (in conjunction with the write-down pursuant to points (a), (b) and (c)) to produce the aggregate amount.

When applying the write-down and conversion powers in compliance with points (b), (c) and (d), resolution authorities should allocate the losses represented by the aggregate amount equally between liabilities of the same rank by reducing the principal amount of, or outstanding amount payable in respect of, those liabilities to the same extent pro rata to their value.

Where an institution has issued instruments, other than those mentioned in (a), that contain either of the following terms:

(a) terms that provide for the principal amount of the instrument to be reduced on the occurrence of any event that refers to the financial situation, solvency or levels of own funds of the institution;

(b) terms that provide for the conversion of the instruments to shares or other instruments of ownership on the occurrence of any such event,

and the terms mentioned in point (a) or point (b) have not taken effect, resolution authorities should reduce the principal amount of the instrument or convert it in accordance with those terms before exercising the write-down and conversion powers to the liabilities mentioned in points (b), (c) and (d).

Question box 4

4a. *Which of the two options do you consider more appropriate in order to mitigate any systemic impact of the use*

[13] See section 6(c) below for the discussion on the notion of the "aggregate amount"

of the tool and minimise the impact in funding costs?
4b. *If you do consider the sequential model to be suitable Do you consider that derivatives that are cleared through a CCP should be treated differently from other derivatives in a bail-in?*

5.- Minimum requirement for eligible liabilities

Given that some liabilities are excluded from the scope of the debt write- down tool, banks could decide to shift most of their liabilities into instruments that could not be subject to bail-in and consequently the usefulness of the tool would be impaired. Therefore, this raises the question of whether there is a need to establish a minimum requirement for eligible liabilities.

In this respect three options could be considered. The first option would be that the legislation does not include any obligation for the institutions subject to the regime to have a minimum amount of bail in able liabilities. For the reasons exposed above this option could impair the effectiveness of the debt write-down tool. The second option would be to establish a requirement for a minimum amount of bail-inable liabilities whilst leaving it to the resolution authorities to determine its precise level on a case by case basis. The framework should set out the criteria on the basis of which the authorities should determine the level for each institution. In order to ensure uniform application of these criteria, the European Banking Authority should be empowered to develop regulatory technical standards to specify these criteria. However, such a system, if not correctly framed, could also lead to divergent applications and therefore, by not ensuring a sufficient loss absorption capacity for all European institutions, undermine the effectiveness of the framework and create an uneven playing field in the Internal Market. The third option would be to determine a concrete minimum amount of eligible liabilities to be maintained by the institutions subject to the debt write-down tool. This option could be applicable both under Option 1 or Option 2 above (See point 4. Whilst for Option 1 the minimum amount would refer to all included liabilities for Option 2 this minimum amount would refer to long term liabilities). This option would have the advantage of ensuring a level playing field, ensure the effective application of the tool and avoid arbitrage. It does however have all the disadvantages of a one-size-fits-all approach.

With respect to the third option, the minimum amount of eligible liabilities should be quantified. Considering the losses observed during the current crisis, 10% of total liabilities could be an adequate amount. Such a figure could have ensured that extreme cases could have been resolved through the application of the tool. According to estimates it should also ensure that future losses can be covered. A higher threshold could increase the cost of funding for banks excessively, thereby potentially making the cost of this tool higher than its potential benefits[14]*.*

Without prejudging the on-going discussions of the Commission Proposal for a Directive on Deposit Guarantee Schemes[15]*, the threshold for bail-inable instruments could be related to the use of the DGS to cover the losses that could be allocated to deposits. The objective should be an optimal calibration between this threshold and the ex-ante contribution for DGS/Resolution Funds (RF).*

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[14] According to the Commission services' estimates, the EU banking system would on average not be subject to any substantial deleveraging in the case this threshold was introduced as of 2018 or even as of 2015.

[15] COM(2010)368 final

It might be preferable to fix the minimum amount in terms of total liabilities rather than in terms of Risk Weighted Assets (RWA). Concerns have been raised that RWA underestimate the possible losses that could be suffered by financial entities. For this reason, it is considered that non-weighted liabilities are a more conservative means of determining what could be the effect of a failure on the balance sheet of a bank.

Because insolvency law applies to individual entities, the resolution tools would be applied by the resolution authorities on an institution by institution basis. This would not mean that there should not be arrangements for dealing with the failure of groups in a manner which ensures that resolution maximises the value of the group as a whole, but these measures would then need to be implemented at institution level by the authority which is competent in each jurisdiction. For this reason, it is considered more effective to introduce a minimum requirement for all the institutions that are part of a group and not only on the holding company.

Main features of the regime

Option 1 (minimum amount at the discretion of resolution authorities)

1. Resolution authorities should ensure that institutions maintain, at all times, an adequate amount of eligible liabilities, which may be defined as a proportion of the total liabilities of the institution.

2. For the purposes 1, resolution authorities should determine what amount or proportion of eligible liabilities is adequate on the basis of the following criteria;

   (a) the need to ensure that the institution can be resolved by the application of the resolution tools including, where appropriate, the debt write-down tool, in a way that meets the resolution objectives;

   (b) the need to ensure, in appropriate cases, that the institution has sufficient eligible liabilities to ensure that, if the debt write-down tool were to be applied on an open bank scenario, the Common Equity Tier 1 ratio of the institution could be restored to a level necessary to sustain sufficient market confidence in the institution and enable it to continue to comply with the conditions for authorisation and to carry on the activities for which is authorised under Directive 2006/48/EC or Directive 2004/39/EC;

   (c) the size, the business model and the risk profile of the institution;

   (d) the degree of interconnectedness of the institution with other institutions or with the rest of the financial system, and

   (e) the extent to which the failure of the institution would have an adverse effect on financial stability, including through contagion to other institutions.

3. Resolution authorities should make the determination required by paragraph 2 in the course of developing and maintaining resolution plans.

4. Where a resolution authority determines that the amount or proportion of eligible liabilities of an institution is not adequate, it shall require the institution to increase the amount or proportion of eligible liabilities.

5. Institutions shall comply with these requirements on an individual basis.

6. Institutions that are subsidiaries or parent undertakings, financial holding companies and mixed financial holding companies should comply with the requirements laid down before on an individual basis. Liabilities held by other entities that are part of the group should be excluded from the amount of eligible liabilities specified before.

7. The Commission shall adopt delegated acts to specify the amount or proportion of eligible liabilities.

Option 2a) (concrete minimum amount – no sequential application)

1. Resolution authorities should ensure that institutions maintain, at all times, an aggregate amount of own funds, subordinated debt that is not Additional Tier 1 or Tier 2 capital and eligible liabilities that is equal or higher than 10 per cent of the total liabilities of the institution that do not qualify as own funds under Section 1 of Chapter 2 of Title V of Directive 2006/48/EC or under Chapter IV of Directive 2006/49/EC.

2. Liabilities arising from derivatives should be excluded from the amount of eligible liabilities specified in the first subparagraph.

3. Resolution authorities could waive the requirement laid down before or require an aggregate amount of own funds, subordinated debt that is not Additional Tier 1 or Tier 2 capital and eligible liabilities, lower than the percentage laid down before, for institutions that are not systemically relevant on the basis of the assessment carried out by the resolution authority.

4. Institutions should comply with these requirements on an individual basis.

5. Institutions that are subsidiaries or parent undertakings, financial holding companies and mixed financial holding companies should comply with the requirements laid down before on an individual basis. Liabilities held by other entities that are part of the group should be excluded from the amount of eligible liabilities specified before.

6. Resolution authorities should verify that institutions maintain the amount of eligible liabilities required in the course of developing and maintaining resolution plans.

Option 2b) (concrete minimum amount – sequential application)

1. Resolution authorities should ensure that institutions maintain, at all times, an aggregate amount of own funds, subordinated debt that is not Additional Tier 1 or Tier 2 capital and eligible liabilities with an original maturity of more than one year that is equal or higher than 10 per cent of the total liabilities of the institution that do not qualify as own funds under Section 1 of Chapter 2 of Title V of Directive 2006/48/EC or under Chapter IV of Directive 2006/49/EC.

2. Liabilities arising from derivatives should be excluded from the amount of eligible liabilities specified in the first subparagraph.

3. Resolution authorities could waive the requirement laid down before or require an aggregate amount of own funds, subordinated debt that is not Additional Tier 1 or Tier 2 capital and eligible liabilities with an original maturity of more than one year, lower than the percentage laid down before, for institutions that are not systemically relevant on the basis of the assessment carried out by the resolution authority.

4. Institutions should comply with these requirements on an individual basis.

5. Institutions that are subsidiaries or parent undertakings, financial holding companies and mixed financial holding companies should comply with the requirements laid down before on an individual basis. Liabilities held by other entities that are part of the group should be excluded from the amount of eligible liabilities specified before.

6. Resolution authorities should verify that institutions maintain the amount of eligible liabilities required in the course of developing and maintaining resolution plans.

Question box 5

5a. *Which do you consider is the best way to fix a minimum amount of bail-inable liabilities – option 1 or 2a), 2b)? If you consider option 1 preferable how could possible fragmentation of the internal market and unlevel competitive conditions within the Internal Market be avoided? How would clarity and predictability be ensured under option 1?*
5b. *What do you think is the optimal minimum level of bail-inable liabilities + capital (e.g. 10% of total liabilities excluding own funds) to prepare for future potential crisis?*
5c. *Would a minimum amount of bail-inable liabilities + regulatory capital have an excessive negative effect on certain types of banking businesses present in Europe (retail vs. investment banking)? Would it be necessary to establish an exclusion from the minimum rule for certain banks or no rule at all (e.g. small banks, overwhelmingly deposit financed, mortgage banks)?*
5d. *Do you consider that the requirement to hold a minimum amount of bail-in-able liabilities should be set both at holding and subsidiary level? Do you consider that resolution authorities should be allowed to apply the requirement exclusively at holding level if that is agreed by all the competent resolution authorities in the context of the resolution plans?*

6.- Implementation of debt write-down: other issues

When the debt write-down tool is applied the original liability should extinguish in whole or in part.

In order to facilitate a rapid execution of the tool in those cases where the debt is written down and converted into capital it is necessary that all the substantial and procedural requirements related to company law are respected beforehand. In this respect it would be necessary that, if in the context of the resolution plans the application of the debt write-down is foreseen, it is ensured that institutions have the preliminary authorisation of shareholders to issue a sufficient amount of shares for carrying out the conversion of debt into capital.

It would be critical that the determination of the amount of the write-down is done on the basis of an adequate estimation of the losses. As would be the case for the other tools, the aim is that losses are recognised at the moment of the entry into resolution. This would allow for effectively dealing with the problems detected in the institution, underpin market confidence and avoid any temptations of forbearance. It is noted that an adequate valuation should be preceded by a substantial amount of preparatory work by the competent and resolution authorities in the context of the resolution plans. To this end the resolution legal framework should establish sufficient arrangements *to try to ensure that all appropriate elements to proceed with an adequate valuation will be readily available to the resolution authority at the moment when it decides to put the institution under resolution*[16].

The amount by which the liabilities should be written down has to take into account both the losses and the need to recapitalise the institution to the extent necessary to underpin its future viability whilst reassuring market counterparties.

It would not be necessary to cancel the original shares in all the cases when the debt-write-down tool is applied. It is considered that current shareholders could also be sufficiently penalised if conversion takes place at a rate that is sufficiently detrimental for them taking into account the amount of the losses considered and the capital needs of the institution.

In accordance with what was mentioned before in relation to derivatives a number of practical issues would need to be defined in order to ensure a correct application of the tool. The Commission services note that, in any case if the tool is to be applied to derivatives, netting agreements, if they exist, should be safeguarded.

<u>Main features of the regime</u>

6 (a) - Effect of debt write-down

Where a resolution authority would exercise the debt write-down tool, the reduction of principal or outstanding amount due, conversion or cancellation (as the case may be) takes effect and is immediately binding on the institution under resolution and affected creditors and shareholders. All the administrative and procedural tasks necessary to give effect to the exercise of the tool should be completed, including:

(a) the amendment of all relevant registers;

(b) the delisting or removal from trading of shares or debt instruments;

(c) the listing or admission to trading of new shares.

Where a resolution authority would reduce to zero the principal amount of, or outstanding amount payable in respect of, a liability by means of the debt write-down tool, that liability and any obligations or claims arising in relation to it that are not accrued at the time when the tool is exercised should be treated as discharged for all purposes, and should not be provable in any subsequent proceedings in relation to the institution under resolution or any successor institution in any subsequent winding up.

Where a resolution authority would reduce in part, but not in full, the principal amount of, or outstanding amount payable in respect of, a liability by means of the debt write-down tool:

(a) the liability should be discharged to the extent of the amount reduced; and

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16 For example, in the context of resolution plans the institutions would be obliged to provide the following information to the resolution authorities: "a description of the arrangements that the institution has in place to ensure that, in the event of resolution, the resolution authority will have all the necessary information, as determined by the resolution authority, for applying the resolution tools and powers".
Besides, in analysing the resolvability of the institution, the resolution authorities would need to be reassured as to: "The capacity of the management information systems to provide the information essential for the effective resolution of the institution or the group at all times even under rapidly changing conditions" or "The adequacy of the management information systems in ensuring that the resolution authorities are able to gather accurate and complete information regarding the core business lines and critical operations so as to facilitate rapid decision making".

(b) the relevant instrument or agreement that created the original liability should continue to apply in relation to the residual principal amount of, or outstanding amount payable in respect of the liability, subject to any modification of the amount of interest payable to reflect the reduction of the principal amount, and any further modification of the terms that the resolution authority might make by means of the debt write-down tool.

6 (b) - Removal of procedural obstacles to debt conversion

Resolution authorities should, in appropriate cases, require institutions to maintain at all times sufficient authorised share capital so that, in the event that the resolution authority exercised the debt write-down tool in relation to an institution or its subsidiaries, the institution would not be prevented from issuing sufficient new shares or instruments of ownership to ensure that the conversion of liabilities into ordinary shares or other instruments of ownership could be carried out effectively.

Resolution authorities should assess whether it is appropriate to impose the previous requirement in the case of a particular institution in the context of the development and maintenance of the resolution plan for that institution having regard, in particular, to the resolution actions contemplated in that plan.

Institutions should be required to ensure that there are no procedural impediments to the conversion of liabilities to ordinary shares or other instruments of ownership existing by virtue of their instruments of incorporation or statutes, including pre-emption rights for shareholders or requirements for the consent of shareholders to an increase in capital.

6 (c) - Assessment of amount of debt write-down

When applying the debt write-down tool, resolution authorities should assess the aggregate amount[17] by which eligible liabilities must be reduced on the basis of a valuation that complies with the requirements generally established for the valuation of an entity that has entered into resolution[18] [19].

Where resolution authorities would apply the debt write-down tool in an open bank scenario, the assessment should establish the amount by which eligible liabilities need to be reduced in order to restore the Common Equity Tier 1 capital ratio of the institution under resolution and the amount that the resolution authority considers necessary to sustain sufficient market confidence in the institution and enable it to continue to comply with the conditions for authorisation and to carry on the activities for which is authorised under Directive 2006/48/EC or Directive 2004/39/EC.

[17] 'aggregate amount' means the aggregate amount by which the resolution authority has assessed that covered eligible liabilities must be written down

[18] When applying the resolution tools and exercising the resolution powers, resolution authorities shall ensure that a fair and realistic valuation of the assets and liabilities of the institution is carried out by a person independent from both the resolution authority and the institution. The resolution authority shall endorse this valuation. Where independent valuation is not possible due to the urgency of the circumstances of the case, resolution authorities may carry out the valuation of the assets and liabilities of the institution.

[19] Without prejudice to the Union State Aid framework, where applicable, the valuation required before shall be based on prudent and realistic assumptions, including as to rates of default and severity of losses, and its objective shall be to assess the market value of the assets and liabilities of the institution that is failing or is likely to fail so that any losses that could be derived are recognised at the moment the resolution tools are exercised. Valuation shall not assume the provision of extraordinary public support to the institution, regardless of whether it is actually provided.

Resolution authorities should establish and maintain arrangements to ensure that the assessment and valuation is based on information about the assets and liabilities of the institution under resolution that is as up to date and comprehensive as is reasonably possible.

6 (d) - Treatment of shareholders

When applying the debt write-down tool, resolution authorities should take one or both of the following actions in respect of shareholders:

(a) cancel existing shares;

(b) exercise the power to convert eligible liabilities into shares of the institution under resolution at a rate of conversion that severely dilutes existing shareholdings.

The previous requirement would apply in respect of shareholders where the shares in question were issued or conferred in the following circumstances:

(a) pursuant to conversion of debt instruments to shares in accordance with contractual terms of the original debt instruments on the occurrence of an event that preceded or occurred at the same time as the assessment by the resolution authority that the institution met the conditions for resolution;

(b) pursuant to the conversion of relevant capital instruments to Common Equity Tier 1 instruments.

When considering which action to take, resolution authorities should have regard to the following factors:

(a) the likely amount of losses relative to assets before the exercise of the debt write-down tool, with a view to ensuring that the action taken in respect of shareholders is consistent with that reduction in equity value; and

(b) the valuation carried out by the resolution authorities and in particular to the likelihood that shareholders would have recovered any value if the institution had been wound up on the basis of that valuation.

6 (e) - Implementation of debt write-down: derivatives

When resolution authorities would apply the write-down and conversion powers to liabilities arising from derivatives they should do so in accordance with the following:

Where transactions are subject to a netting agreement, resolution authorities should determine the liability arising from those transactions on a net basis in accordance with the terms of the agreement.

Resolution authorities should determine the value of liabilities arising from derivatives in accordance with delegated acts. They should include appropriate methodologies for determining the value of classes of derivatives, including transactions that are subject to netting agreements; and principles for establishing the relevant point in time at which the value of a derivative position should be established.

6 (f) - Rate of conversion of debt to equity

When applying the debt restructuring by exercising the power to convert eligible liabilities into ordinary shares or other instruments of ownership, resolution authorities could apply a different conversion rate[20] to different classes of liability in accordance with one or both of the principles set out below.

The conversion rate should represent appropriate compensation to the affected creditor[21] for the loss incurred by virtue of the exercise of the write-down and conversion power.

The conversion rate applicable to senior liabilities should be higher than the conversion rate applicable to subordinated liabilities, where that is appropriate to reflect the priority of senior liabilities in winding up under applicable insolvency law.

Question box 6

6. *Do you agree that there should not be an absolute obligation to cancel existing shares? Would it be enough in certain cases to establish a sufficiently penalising rate of conversion?*

7.- Recovery and reorganisation measures to accompany debt write-down

The European resolution framework that the Commission services intend to propose will include elements on recovery and reorganisation measures that entities will have to undergo in case of resolution. The reorganisation of the business will take place not only in case of a bail-in, but also when any other resolution tools are triggered.

In the case of the use of the bail-in tool, the writing down of certain liabilities would not be the end of the resolution process.

The bail-in would need to be accompanied by significant restructuring to return a 'new' institution to viability. While debt write-down (unless used in conjunction with other resolution tools) would preserve the legal entity and technically maintain the institution as a going concern (for example, so as not to trigger close out provisions), the use of such a tool must be accompanied by significant restructuring measures, including the sale or closure of parts of the business, necessary to restore it to long term financial viability. In line with the Union State Aid framework, restructuring may also be required to the extent that the institution has benefited from state aid to ensure that the criteria of viability, burden sharing and measures to limit distortion of competition are met. Statutory control of the process will ensure that the write-down is accompanied by restructuring, removal of problem assets, replacement of management or any other measure necessary to put an institution on a sound footing for future viability. The support, if necessary, of liquidity provision from the resolution fund or Central Banks, and without prejudice to the

[20] 'conversion rate' means the factor that determines the number of ordinary shares into which a liability of a specific class will be converted, by reference either to a single instrument of the class in question or to a specified unit of value of a debt claim.
[21] 'affected creditor' means a creditor whose claim relates to a liability that is reduced or converted to shares by means of the write-down or conversion power.

Union State Aid framework, could also play a key role in supporting the process. The institution and its business, its owners and management would therefore change substantially in the short to medium term.

Main features of the regime

Where resolution authorities would apply the debt write-down tool to an institution in an open bank scenario, arrangements should be adopted to ensure that a business reorganisation plan for that institution is drawn up and implemented.

The arrangements should include the replacement of senior management and the appointment of an administrator with the objective of drawing up and implementing the business reorganisation plan.

Within one month after the application of the debt write-down tool to an institution, the administrator should draw up and submit to the resolution authority a business reorganisation plan. Where the EU State Aid framework is applicable, Member States should ensure that such plan is compatible with the restructuring plan that the institution is required to submit to the Commission under that framework.

A business reorganisation plan should set out measures aimed at restoring the long term viability of the institution or parts of its business within a reasonable timescale no longer than two years. Those measures should be based on realistic assumptions as to the economic and financial market conditions under which the institution will operate.

A business reorganisation plan should include the following elements:

(a) a detailed diagnosis of the factors and problems that caused the institution to fail or to be likely to fail, and the circumstances that led to its difficulties;

(b) a description of the measures aimed at restoring the long-term viability of the institution that are to be adopted;

(c) a timetable for the implementation of those measures.

Measures aimed at restoring the long-term viability of an institution could include:

(a) the reorganisation of the activities of the institution;

(b) the withdrawal from loss-making activities;

(c) the restructuring of existing activities that can be made competitive;

(d) the sale of assets or of business lines.

Within one month of the date of submission of the business reorganisation plan, the resolution authority should assess the likelihood that the plan, if implemented, would restore the long term viability of the institution.

If the resolution authority is satisfied that the plan would achieve that objective, it should approve the plan.

If the resolution authority is not satisfied that the plan would achieve that objective the resolution authority should notify the administrator of its concerns and require the administrator to amend the plan in way that addresses those concerns.

Within two weeks of receiving such a notification, the administrator should submit an amended plan to the resolution authority for approval. The resolution authority should assess the amended plan, and should notify the administrator within one week of whether it is satisfied that the plan, as amended, addresses the concerns notified or whether further amendment is required.

The administrator should implement the reorganisation plan as agreed by the resolution authority, and should report every six months to the resolution authority on the progress in the implementation of the plan.

The administrator should revise the plan if that is necessary to achieve its aims and should submit any such revision to the resolution authority for approval.

Question box 7

7. *Do you consider that a business reorganisation plan should be presented soon (e.g. 1 month) after the application of the bail-in tool? Should this only apply in the case of an open bank bail-in or also for a closed bank bail-in?*

8.- Contractual provisions

It has been observed that in order to ensure the continuity of the institution that has been subject to the application of the debt write-down tool, any possibility to proceed to the closure of the contracts between the institution and its counterparties should be prevented.

It would also be necessary to ensure a contractual recognition of the use of the statutory powers by the resolution authority especially in those jurisdictions where European law does not apply. Otherwise the effectiveness of the whole process would be jeopardised.

Main features of the regime

8 (a) - Events of default

All necessary measures should be taken to prevent institutions from including in the contractual terms of an excluded liability any termination right that is exercisable as a result of the application of the debt write-down tool to the institution or an affiliated entity.

Any provision of the contractual terms of an excluded liability that purports to confer termination rights in contravention with what has been mentioned before should be void.

8 (b) - Contractual recognition of debt write-down

Institutions should be required to include in the contractual provisions governing any eligible liability, Additional Tier 1 instrument or Tier 2 instrument that is governed by the law of a jurisdiction that is not a Member State of the European Union a term by which the creditor or party to the agreement creating the liability recognises that the liability may be subject to the write-down and conversion powers and agrees to be bound by any reduction of principal or outstanding amount due, conversion or cancellation that is effected by the exercise of the those powers by a resolution authority.

If an institution fails to include in the contractual provisions governing a relevant liability a term required, that failure should not prevent the resolution authority from exercising the write-down and conversion powers in relation to that liability.

Question box 8

8. *Do you consider that including a contractual recognition of the debt write down would facilitate the enforcement of the debt write down powers with respect to instruments issued under the law of a third country?*

9.- Timing for the application of the debt write-down tool

Concerns have been expressed about the potential impact of the legislative proposal on the funding of EU banks given the current market conditions. In particular, the potential effects of the proposal could be that the cost of funding for some banks could change and/or that creditors would increasingly distinguish between more and less creditworthy banks.

There are three issues to be addressed:

First, the date of application of the requirements related to the EU debt write-down tool. This means in practice that bail-in related provisions would only enter into force some time after the adoption/implementation of the proposal.

Second, the issue of how debt issued before that date is treated ("grandfathering") and in particular whether or not it should be covered by the proposed debt-write down tool/regime.

Third, the type of transitional arrangements that would be needed (if any) (i) for the building of the minimum requirement of "bail-inable" liabilities (ii) for the transition of outstanding contracts into the new regime.

Question box 9

9a. *According to your views, what would be the likely impact of the debt write down tool? What measures (if necessary) could be envisaged to mitigate such impact?*

9b. *Do you consider that the bail-in tool provisions should only become applicable after a certain date in the future? What do you think that date should be?*

9c. *Do you consider that it would be desirable to exclude debt issued before a certain date from the scope of bail-in* *(grandfathering)?*

9d. *Do you consider that there is a need to foresee a transitional period/progressive phase-in for the building of the minimum requirement of "bail-in-able" liabilities? What do you think it should be and over how many years?*