

EBA/CP/2022/06

07/06/2022

Consultation Paper

Guidelines to resolution authorities on the publication of the write-down and conversion and bail-in exchange mechanic

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1. Responding to this consultation

The EBA invites comments on all proposals put forward in this paper and in particular on the specific questions summarised in 5.2.

Comments are most helpful if they:

- respond to the question stated;
- indicate the specific point to which a comment relates;
- contain a clear rationale;
- provide evidence to support the views expressed/ rationale proposed; and
- describe any alternative regulatory choices the EBA should consider.

Submission of responses

To submit your comments, click on the 'send your comments' button on the consultation page by 07/09/2022. Please note that comments submitted after this deadline, or submitted via other means may not be processed.

Publication of responses

Please clearly indicate in the consultation form if you wish your comments to be disclosed or to be treated as confidential. A confidential response may be requested from us in accordance with the EBA's rules on public access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the EBA's Board of Appeal and the European Ombudsman.

Data protection

The protection of individuals with regard to the processing of personal data by the EBA is based on Regulation (EU) 1725/2018 of the European Parliament and of the Council of 23 October 2018. Further information on data protection can be found under the Legal notice section of the EBA website.

2. Executive Summary

International standards on resolution expect home authorities to publish their approach to the exchange mechanic, i.e the operational process allowing the write down of capital instruments or bail-inable liabilities or conversion into new shares. This is to increase predictability and credibility of the framework by publicising authorities' readiness to execute bail-in.

The consultation paper for the now published EBA guidelines on improving resolvability for institutions and resolution authorities included a paragraph covering this particular topic.¹ But that element was removed following consultation as it deserved additional analysis.

This stand-alone set of draft guidelines now provides a clear framework for resolution authorities to publish their approach to using the bail-in tool. Authorities that have not done so yet are expected to start publishing a high-level document from January 2024 setting out the key aspects of their favoured approach – in particular if they intend to make use of interim instruments, and those that have already published information are expected to check if that publication complies with these draft guidelines.

Authorities should continuously update that document as they further develop their approach on this complex matter.

Next steps

Following the reception of the comments to the consultation, the final report will be published by the end of 2022.

¹ EBA/GL/2022/01. EBA Guidelines on improving resolvability for institutions and resolution authorities under articles 15 and 16 BRRD (Resolvability Guidelines)

3. Background and rationale

1. Transparency and predictability are key both to the credibility of the resolution framework and to the safeguard of the investor protection. Practices by institutions and authorities differ with regard to the publication of information on how they would effectively execute the write down and conversion of capital instruments and the use of the bail-in tool (“exchange mechanic”). There is, therefore, a need to issue guidelines with a view to ensure that a minimum level of harmonized information is made public with regard to exchange mechanic.
2. Directive 2014/59/EU² (BRRD) provides authorities with the powers to write-down and convert capital instruments, it also sets-out that Member States shall ensure that resolution authorities may apply the bail-in tool to achieve the resolution objectives. Authorities have been working on developing their approaches to exchange mechanic.
3. The exchange mechanic is a complex matter, largely involving the implementation of national, non harmonised legislation. In the Banking Union, National Resolution Authorities will be in charge of executing the decision adopted by the Single Resolution Board. To foster transparency, in particular with regards to difficulties in a cross-border context and taking related risks into account, with these guidelines, EBA aims to increase predictability and minimize uncertainty for investors in resolution. To that end, it is essential that resolution authorities set-out their favoured approach on exchange mechanic specifying, in particular, (i) whether they intend to make use of interim instruments or not, (ii) an indicative timeline for the application of the exchange mechanic and (iii) how potential valuation adjustments would take place.
4. Beyond the entities to be resolved, and their investors, other stakeholders play a key role in the execution of the bail-in tool, for instance, CSDs, stock exchanges and their supervisory authority, and custodian banks involved. The readiness of various stakeholders to participate in this complex process is key to the smooth implementation of the bail-in tool.
5. Publication of the exchange mechanic by the resolution authority is an efficient way of enhancing the appropriate level of information of all players involved and it is recommended by the Financial Stability Board under principle 10 of its ‘Principles of bail-in execution’³.
6. Some EU authorities have started to publish their approach to the exchange mechanic, with varying levels of granularity. With these guidelines, the EBA proposes a framework to increase consistency in the publication of the exchange mechanic by authorities.

² Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014, establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council (OJ L 173 12.6.2014, p. 190).

³ <https://www.fsb.org/wp-content/uploads/P210618-1.pdf>

7. In light of the complexity of the matter, the publication of the exchange mechanic should (i) make clear that actual execution may differ and (ii) be a living document to be updated as further progress is made by authorities.
8. Beyond initial publication of the exchange mechanic, resolution authorities have significant work to undertake, in determining and developing their favoured approach. To do so they can leverage on the work done by the Financial Stability Board on the topic⁴.
9. Resolution authorities are not in charge of all aspects of the exchange mechanics. But so as to increase clarity of the framework they should aim to describe their understanding of how other stakeholders would act – or at least designate these stakeholders as responsible for certain actions, to ensure the smooth implementation of the resolution strategy and to enhance effective coordination of resolution plans and actions in a cross-border context.
10. In the context of the Banking Union, whilst considering the relevance of the national legal frameworks, the national resolution authorities (NRAs) of the Banking Union countries where the institution is established are better placed to publish the exchange mechanic for their jurisdiction. The Single Resolution Board might publish a list of links to the publications made available by the NRAs of the Banking Union countries.

⁴ <https://www.fsb.org/2021/12/bail-in-execution-practices-paper/>

4. Guidelines

EBA/GL/2022/XX

DD Month YYYY

Draft Guidelines

Guidelines to resolution authorities on
the publication of the write-down and
conversion and bail-in exchange
mechanic

1. Compliance and reporting obligations

Status of these guidelines

1. This document contains guidelines issued pursuant to Article 16 of Regulation (EU) No 1093/2010⁵. In accordance with Article 16(3) of Regulation (EU) No 1093/2010, competent authorities and financial institutions must make every effort to comply with the guidelines.
2. Guidelines set the EBA view of appropriate supervisory practices within the European System of Financial Supervision or of how Union law should be applied in a particular area. Competent authorities as defined in Article 4(2) of Regulation (EU) No 1093/2010 to whom guidelines apply should comply by incorporating them into their practices as appropriate (e.g. by amending their legal framework or their supervisory processes), including where guidelines are directed primarily at institutions.

Reporting requirements

3. According to Article 16(3) of Regulation (EU) No 1093/2010, competent authorities must notify the EBA as to whether they comply or intend to comply with these guidelines, or otherwise with reasons for non-compliance, by **[2 months after publication of translation of the guidelines]**. In the absence of any notification by this deadline, competent authorities will be considered by the EBA to be non-compliant. Notifications should be sent by submitting the form available on the EBA website with the reference 'EBA/GL/202x/xx'. Notifications should be submitted by persons with appropriate authority to report compliance on behalf of their competent authorities. Any change in the status of compliance must also be reported to EBA.
4. Notifications will be published on the EBA website, in line with Article 16(3).

⁵ Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC, (OJ L 331, 15.12.2010, p.12).

2. Subject matter, scope and definitions

Subject matter

5. To enhance predictability of the write-down and conversion and bail-in exchange mechanic, effective coordination of resolution plans and actions in a cross-border context and transparency and safeguard depositor and investor protection, these guidelines specify information to be made public by resolution authorities on how the write down and conversion will be applied, in particular in the context of the bail-in tool, in accordance with Articles 43 and 44, 46 to 50 and 59 to 62 of Directive 2014/59⁶.

Scope of application

6. These guidelines apply in accordance with the scope of application as set out in Directive 2014/59.

Addressees

7. These guidelines are addressed to competent authorities as defined in points (v) of Article 4 (2) of Regulation (EU) No 1093/2010 (“resolution authorities”).

Definitions

8. Unless otherwise specified, terms used and defined in Directive 2014/59/EU and the EBA resolvability guidelines have the same meaning in these guidelines.

Exchange mechanic	Operational steps necessary to execute the write down and conversion of relevant capital instrument or the use of the bail-in tool.
Interim instrument	A financial instrument issued for the purpose of allowing a conversion from capital instruments and bail-inable liabilities into that instrument, as a first step in the bail-in process and meant to be converted/ exchanged after definitive valuation into a definitive instrument, most likely an equity security.

⁶ Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014, establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council (OJ L 173 12.6.2014, p. 190).

3. Implementation

Date of application

9. These guidelines apply from 1 January 2024.

4. Guidelines to resolution authorities on the publication of the write-down and conversion and bail-in exchange mechanics

4.1 Publication of the exchange mechanic

10. Resolution authorities should publish on their website a high-level description of their approach to the execution of the write-down and conversion of capital instruments and bail-inable liabilities (“Description of the Exchange Mechanic”) from the preliminary steps to the final execution of the exchange mechanic, including any ex post definitive valuation adjustments, where applicable.
11. The Description of the Exchange Mechanic should at least include the following information:
- a. Identity and role of the stakeholders to be involved in the process of the Exchange Mechanic, including , where possible, contact details.
 - b. Approach to the discontinuation or suspension of trading and delisting or removal of instruments from the trading venues.
 - c. Description for the write-down and cancellation of relevant instruments, including possible solutions for dealing with instruments whose transactions have not yet been settled (“in-flight transactions”).
 - d. Detailed description of the conversion process, which may refer to one of the following:
 - i. Conversion of bailed-in instruments or liabilities into new equity (“direct conversion”);



- ii. Conversion of bailed-in instruments or liabilities involving interim instruments;
 - iii. a mix of both.
- e. Approach to address potential differences between definitive ⁷ and provisional valuation, such as a write-up in case of over-conversion
 - f. An approach to dealing with any fractional shares.
 - g. An indicative timeline for the steps above to be realised.
12. In the Description of the Exchange Mechanic , it should be stated that actual execution of write-down and conversion processes might differ from the one set out in that Description.
13. Resolution authorities should update the Description of the Exchange Mechanic, where their approach is changed. In the Description of the Exchange Mechanic, it should be clearly stated that this is a living document susceptible to updates.

5. Accompanying documents

5.1 Draft cost-benefit analysis / impact assessment

I. Introduction

International standards expect home authorities to publish their approach the exchange mechanic i.e the operational process allowing the write down and conversion of bail-inable instruments into new shares. The consultation paper for the EBA published guidelines on improving resolvability for institutions and resolution authorities included a paragraph covering this particular topic.⁸ The need to publish the exchange mechanic was however taken out of the final report on the ground that the legal basis and the format needed to be specified. This stand-alone set of guidelines aims to set-out a clear framework for the publication of the exchange mechanics by resolution authorities.

II. Policy objectives

The aim of the guidelines is the publication by EU Resolution Authorities of their approach to the implementation of the bail-in tool and the steps to fulfil the write-down of instruments and conversion into newly issued instruments in order to recapitalize the bank – going forward the exchange mechanic. The guidelines seek to strengthen increase harmonisation with regard to the publication of the exchange mechanic. The proposal is for them to publish their website the steps they expect to follow at the point of resolution – in particular they should set out whether they intend to make use of interim instruments. The guidelines prescribe a minimum list of points that should be covered in the process, giving enough flexibility to resolution authorities to include other aspects as they progress in developing their mechanic.

III. Baseline scenario

In the field of resolution, international standards are set by the by the Financial Stability Board. In its principles of bail-in execution published in November 2017⁹, the FSB sets out the expectation that home authorities disclose their exchange mechanic to “enhance the credibility and predictability of actions to execute the exchange.” Some EU authorities (NL, DE) have effectively done so but not all.

IV. Options considered

⁸ <https://www.eba.europa.eu/eba-consults-its-draft-guidelines-institutions-and-resolution-authorities-improving-resolvability>

⁹ <https://www.fsb.org/wp-content/uploads/P301117-1.pdf>

The guidelines aim at setting out the minimum elements that authorities should publish about their exchange mechanics. In the process of drafting the guidelines, the following policy options were considered.

Option 1: Prescriptive and detailed list of phases of the exchange mechanic published after January 2024

This option would provide the highest level of clarity and transparency to all stakeholders involved. (e.g. institutions, central security depository, holders of bail-in instruments). This approach for instance has been followed by BaFin in Germany. But this would require authorities to have fully clarified all aspects of the exchange mechanics by the time they need to publish. But not all authorities have effectively fully developed their approach and thus the deadline for the publication would need to be pushed back beyond 2024. Some authorities also worry that publishing a very detailed approach may restrict them at the point of executing the bail-in or expose them to lawsuits.

Option 2: High level description of the approach of the exchange mechanic published 1 January 2024

This option would ensure that, by January 2024, all authorities will have published basic information about their approach and in particular - (i) whether it is intended to make use of interim entitlements or not, (ii) how quickly it is foreseen the return of the institution to private hands and (iii) how potential valuation adjustments would take place. Authorities will update the publication as their progress in developing their approach.

Option 2 is the preferred option.

V. Cost-benefit analysis

The **impact** of implementing the guidelines, which will become applicable from 1 January 2024, depends on the level of clarity from the side of resolution authorities with regards to the process to ensure the execution of bail-in and the level of preparedness of institutions.

The expected **benefits** of the implementation of the guidelines are mainly related to an increased **credibility of the bail-in process** by demonstrating the readiness of authorities in implementing it thus ensuring that losses can be absorbed and recapitalisation can be achieved.

For **institutions and other stakeholders**, the benefits are mainly related to the clarity with regards to the timeline of each of the phases and their roles in the execution of the exchange mechanics.

Bail-in has been a possibility since the entry into force of BRRD in 2015 and thus, resolution authorities, have already developed their approach to execution of bail-in. Therefore, the costs are essentially limited to the finalizing their approach and preparing of a public document detailing it.

5.2 Overview of questions for consultation

Q1: Do you have any comments on the proposed guidelines?

Q2: Do you have any comments on the level of detail of the proposed publication in paragraph 11 of the guidelines?

Q3: Do you support the content and structure of the proposed publication by resolution authorities and coordination as a way of helping the execution of the exchange mechanic for cross border banks?

Q4: Do you have any other suggestions that could improve transparency?