

Principles and Execution of the Bail-in Tool

The bail-in tool is one of four resolution tools available to the Resolution Council (The Council) in response to a crisis situation in an institution in scope of the EU resolution framework established by the BRRD and SRMR.¹ This tool allows the Council to restructure a failing institution while safeguarding its critical functions and minimizing adverse impacts on the economy and financial system.

The Financial Stability Board's (FSB) "Key Attributes of Effective Resolution Regimes for Financial Institutions" which outline the principles of bail-in execution. These principles express the expectation that national resolution authorities establish a credible bail-in execution mechanism. To enhance transparency and predictability for the market players, this mechanism should be publicly disclosed. This expectation is now embedded in the EU guidelines EBA/GL/2023/01, mandating the resolution authorities to publish the bail-in, write-down, and conversion mechanism by January 1, 2024.

In alignment with regulatory requirements for transparency and to enhance awareness and predictability for market participants and investors, the Council publishes a summary of the bail-in execution and a [document](#) providing a comprehensive overview of write-down and conversion and bail-in execution in Slovakia.

As an important disclaimer, the Council notifies all stakeholders that the published processes and templates constitute a "living" document subject to updates. The Council also reserves the right to deviate from the described process if necessary to achieve the resolution goals or due to specific circumstances during resolution of a crisis situation.

Summary of Bail-in Tool Execution

The bail-in mechanism operates by writing down and/or converting creditors' claims into the institution's equity to cover losses and facilitate recapitalization. The operationalization of the Bail-in Tool ensures that creditors suffer appropriate losses after shareholders and owners of other instruments of ownership. Bail-in is performed in a manner that respects the hierarchy of claims prescribed by insolvency law, with junior claims written down and/or converted before claims of a more senior class.

The Council can apply the bail-in tool in respect of an institution or entity in scope of the resolution framework that meets the following conditions for resolution:

1. It is failing or likely to fail (FOLTF).
2. There is no reasonable prospect that a private solution or the use of supervisory actions will rectify the situation.
3. Resolution of the bank is necessary in the public interest.

The assessment of the above conditions by the resolution authority also includes the assessment whether intervention is necessary and proportionate and whether the resolution objectives could not be achieved equally well through insolvency proceedings. Bail-in is legally implemented and executed based on the Council's decision, requiring no consent from shareholders, creditors, or the institution's management. It serves two purposes:

A. Supplementing the institution's own funds through recapitalization, known as "open bank bail-in." The Council applies this form if there's a reasonable expectation that it will lead to the institution's

¹ <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A02014L0059-20221114>
<https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A02014R0806-20220812>

financial recovery, enabling it to meet capital requirements and restore confidence in the financial market. Otherwise, point B) is pursued.

B. Converting institution's obligations into own funds of or reducing debts transferred to a bridge institution to provide resources or apply asset transfer or separation measures.

While sharing the mechanism with the power of write-down and conversion (WDCI), the bail-tool differs in function, assumptions, and scope. Unlike crisis resolution tools, WDCI can be exercised both within and outside resolution, primarily aimed at covering losses and partial recapitalization. If capital instruments and liabilities eligible for WDCI ensure complete recapitalization and resolution objectives are met, crisis resolution measures become unnecessary.

A key distinction lies in the scope of liabilities affected. While bail-in applies to all bail-in eligible liabilities, WDCI exclusively applies to capital instruments (CET1, AT1, T2) and, when exercised outside resolution, to liabilities meeting MREL criteria, excluding an over one-year residual maturity as per Article 72c(1) CRR.

Process of the Bail-in Execution

1. Commencement of Resolution Proceedings

The Council decides on the commencement of resolution proceedings when three conditions for resolution, as outlined above, are met. Depending on the specificities of a given case, the Council may make separate decisions on the initiation of resolution proceedings and the imposition of measures to address a crisis situation.

2. Gathering and Updating of Required Information for WDCI and Bail-in

The Council requires the institution to provide all information from the Management Information System (uploaded to the Virtual Data Room, if possible) at the beginning of the data-gathering process. The data should be supplied close to the date when the institution is determined as FLTF. Depending on the time gap between the initial provision of information and the decision on the scope and subject of WDCI and bail-in, the Council will either use the initial information or request the institution to update the originally provided data.

3. Determination of the Scope of WDCI and Bail-in

The Council may exclude certain eligible liabilities from bail-in under conditions provided by the Act on resolution in the financial market (ZRKS).² Within the process of excluding certain liabilities, it is necessary to identify all instruments that could be written down or converted. The scope is based on information provided by the institution, as defined in its bail-in playbook, included in the Management Information System (MIS) and Virtual Data Room (VDR), and disclosed to an independent valuer that draws up the Valuation 2 report.

4. Appointment of a Special Administrator in Resolution Proceedings

The special resolution administration is appointed by the Resolution Council by a certificate of appointment of the special administrator in accordance with Section 12 et seq. of ZRKS. This measure is considered, pursuant to Section 10 (2) of ZRKS, a measure for management of a crisis situation.

5. Freezing of CET1 Instruments, Relevant Capital Instruments, and Eligible Liabilities

² <https://www.epi.sk/zz/2014-371>

This step covers the following powers of the Council: Suspension of trading/disposal rights to securities, suspension of certain obligations, suspension of the right to terminate a contract, and restriction of the exercise of security rights.

Suspension of trading: The Council may require the National Bank of Slovakia (NBS) or the Stock Exchange to suspend trading of instruments identified in the second step (i.e., within the specified scope of WDCI and capitalization, including CET1 instruments) on the regulated market. Additionally, the Council can propose delisting the relevant instruments. The Council issues an order to suspend trading directly to the Stock Exchange and includes instrument identifiers (ISIN) that should be subject to the trading suspension in the operational part of the decision. The Stock Exchange is obliged to immediately suspend trading of the concerned financial instruments under the Securities Exchange Act.

Suspension of disposal rights: As not all securities concerned by write down and conversion are traded on the regulated market, the Council may decide on the suspension of disposal right regarding the entire issuance of securities. To suspend the disposal rights to securities, the Council follows Article 18 of the Operational Rules of the Central Securities Depository of the Slovak Republic (CDCP).

The Council is also entitled to suspend the rights of contractual parties in cases when execution of such rights would lead to termination of the respective contract or other form of termination of contractual relationship. Such suspension has limitations towards the obligations arising from the contracts concluded with parties listed in ZRKS. Similar limitations apply to the Council's power to decide, pursuant to Section 15 of ZRKS, on restriction of the exercise of security rights.

6. Decision on the scope of WDCI and bail-in

While determining the aggregate amount necessary to be written down or converted, the Resolution Council considers:

1. Available results of Valuation 2:
 - The Valuation 2 report, prepared in accordance with Section 51 of ZRKS, provides the Resolution Council with information on the perimeter of WDCI and bail-in (where it is based on a resolution strategy including a Bail-in Tool) – including an estimate of the aggregate amount, losses that need to be covered, number of instruments that need to be converted to ensure the recapitalisation, conversion rates and preliminary assessment of the NCWO principle.
2. Hierarchy to be followed when performing WDCI and bail-in
 - The hierarchy that should be followed when exercising WDCI and the bail-in is based on the position of the relevant instruments within the insolvency hierarchy;
 - Basic hierarchy should be in accordance with the Act on bankruptcy and restructuring (ZKR)³ and ZRKS, the exact positioning of the instruments could be detectable from the Valuation 2 report (also information on the position of a specific instrument is provided by the institution itself – as part of the data in MIS or VDR).
3. Amount of losses to be absorbed determining the extent of write-down
 - Losses comprise all those incurred and not accounted for;
 - Amount is based on the results of Valuation 2 and Valuation 1;
 - The hierarchy in accordance with ZKR and ZRKS should be followed. If CET1 items are insufficient to cover the loss, the Resolution Council determines the full or partial write-down for each class of relevant capital instruments or bail-inable liabilities by comparing the amount of remaining losses and outstanding amounts (including accrued interest) of a given class of relevant capital instruments or bail-inable liabilities.

³ <https://www.epi.sk/zz/1991-328>

7. Issuance of New Shares

The process of issuing new shares has to be initiated before the Council issues a decision on WDCI and bail-in to ensure alignment of the effective date of the issue of shares and the decision on WDCI and bail-in. The specific number and nominal value of the shares are based on the decision made in the step on the scope of WDCI and bail-in.

Process steps to be initiated before the issue of the decision include informal communication with the Commercial Register, CDCP, and the special administrator (if appointed), informing them of the planned change. The Council may require the institution to issue new shares under Section 9 (1) h) of ZRKS.

8. Execution of WDCI and bail-in

This step includes the following activities:

- a. Decision of the Council on the application of the resolution tool.
- b. Reduction of CET1 items, write-down of relevant capital instruments and bail-inable liabilities and conversion of relevant capital instruments and bail-inable liabilities.
- c. Implementation of the changes connected with the issue of new shares for the recapitalization of the institution.
- d. Proper accounting recording and provision of an updated balance sheet.

The CDCP is responsible for implementing the relevant changes, including the distribution of the shares to the entitled recipients. Slovak law doesn't contain securities interchangeable for newly issued shares. For that reason, the mechanism of exchange will not apply. The newly issued shares are registered with an owner's account or member client's account within the CDCP and allocated to accounts of the new owners after conversion by the CDCP. The new owner's account might be established within the CDCP or by the respective designated CDCP member.

9. Procedures in the Post-Resolution Period

Valuation 3 is performed on a gone-concern basis and involves two key calculations. The first part estimates a hypothetical insolvency procedure, considering various factors such as creditor hierarchy, principles, legal specifics, and typical costs. The second part uses the actual resolution strategy as a basis, focusing on proceeds obtained and their treatment until the resolution proceedings' effectiveness. The concluding part determines the difference in proceeds obtained by shareholders, creditors, or the Deposit Protection Fund, based on the hierarchy in ZKR.

The Resolution Council relies on the concluding part of Valuation 3 to decide on compensation for registered shareholders, creditors, or the Deposit Protection Fund, as outlined in Section 77 of ZRKS.

According to Section 78a of ZRKS, affected shareholders or creditors must apply for compensation, with the right expiring on the last day of the sixth month following the effective day of the decision on the application of write-down or conversion of eligible instruments or resolution tools. The Council provides a template for the application on its webpages.

The final step entails preparation of the Business reorganisation plan (BRP) by the Statutory body of the institution or administrator and its submission to the Council within a month of the application of the decision on the write-down and conversion of eligible instruments and bail-in. The Council may extend the period for submission to two months from the application of the decision. Extension might be used in a situation where it is necessary to notify the BRP in accordance with EU State aid rules – the extension period is then consistent with the deadline laid down in the State aid framework, but its

maximum length is two months from the application of the decision on the write-down and conversion of eligible instruments and bail-in.