

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.

² <https://www.epi.sk/zz/2014-371>

5. Resolution decision and stakeholders involved in the bail-in execution

The decision imposing the bail-in tool on an institution within the Council's remit is issued on the basis of § 39 of the Act No. 371/2014 Coll. on the Resolution of Crisis Situations on the Financial Market (ZORKS). In case of an institution under the SRB's remit, the bail-in tool is implemented under § 39 and § 41 of ZORKS in combination with Article 29 SRMR. The Implementing Act (IA) is adopted by the Resolution Council of the Slovak Republic as the NRA in the form of an administrative decision.

Following participants are involved in the bail-in execution:

1. **Institution under resolution:** According to the Section 41 (4) of ZORKS, the Council's decision is addressed to the representatives of the Institution under resolution. The institution is mainly responsible for internal bail-in execution and instructing the CDCP to conduct respective corporate changes effecting the write and conversion.
2. **CDCP SR (Central Securities Depository of Slovakia):** Receives the Council's decision together with an explicit instruction to block the entry of any new settlement instructions into the settlement system. CDCP SR is responsible for carrying out all corporate actions linked to the write-down and conversion, registering the resulting instruments, and ensuring accurate updates of ownership records. In addition, CDCP SR acts as the **National Numbering Agency**, assigning ISINs and other identifiers to newly issued or converted instruments.
3. **Bratislava Stock Exchange:** instructed to suspend or delist existing instruments and, once the bail-in process is finalised, to admit newly issued instruments to trading.

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

This step covers the following powers of the Council: Prohibition of settlement, 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. The Stock Exchange shall immediately notify the Council and the National Bank of Slovakia of the suspension of trading and shall publish it in nationwide press.

The prohibition of settlement aims at preventing any new settlement orders into settlement systems, enabling an orderly write-down and conversion of securities. The Council implements the suspension of settlement by instructing the CDCP SR to prohibit the entry of new settlement orders into the settlement system. The legal basis for this instruction is provided under § 13(1)(g) of ZORKS. The attached Council's decision accompanies the instruction. The CDCP SR shall execute the prohibition on the entry of new settlement orders into settlement system based on the data on affected instruments detailed in the AI.

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.

Table 1: External execution – overview and timeline

Day	Activity
Days before Friday cut off day (D-x)	<ul style="list-style-type: none"> Council: pre-resolution communication with the bank, the Stock Exchange and the CDCP SR with the aim to ensure necessary HR/systems capabilities and operations during the resolution weekend
Friday cut off day (after 16:00) (D)	<ul style="list-style-type: none"> Council: shall deliver the IA to the bank (including the identification of the affected items and liabilities instruments and the scope of write-down and conversion, the conversion rate in accordance with the valuation); delivery of the instruction to prohibit the entry of new settlement orders into the settlement system until a specified time to the CDCP SR (IA attached) Council: shall deliver of the instruction to suspend trading to the Stock Exchange (IA attached)
Saturday (D+1)	<ul style="list-style-type: none"> Bank: in case of conversion shall request new ISINs from the CDCP SR The Stock Exchange – shall execute the suspension of trading so that it is suspended before the opening of day D+3 and informs the Board thereof
Sunday (D+2)	<ul style="list-style-type: none"> CDCP SR – shall assign a new ISIN and notify the Bank and the Council CDCP SR – shall technically execute the Council's instruction to prohibit the entry of new settlement orders into the settlement system with effect before the opening of day D+3 and shall inform the Council thereof
Monday (D+3)	<ul style="list-style-type: none"> The prohibition on the entry of new settlement orders into the CDCP SR settlement system is effective – settlement of trades (both OTC and exchange-traded) concluded after the Board's decision comes into effect for the affected securities shall not take place Settlement of trades concluded by Friday (D) takes place (including orders submitted on Friday after 18:00 until the maintenance window, with Monday as the settlement date)

	<ul style="list-style-type: none"> Trading on the Exchange is suspended. The Bank shall, by 12:00 (cut-off for instructions), submit orders to execute corporate actions and shall inform the Board thereof
Tuesday (D+4) Record Date	<ul style="list-style-type: none"> CDCP SR shall, after 18:00 (end of day), prepare the lists of owners for the purpose of identifying the holders of the affected securities and shall inform the Board thereof. At 18:50, the trading day D+5 shall open and the corresponding debit/credit instructions for the accounts shall be generated From 20:00, settlement of instructions submitted by the Bank shall take place – CDCP SR shall inform the Board thereof CDCP SR shall lift the prohibition on the entry of new settlement orders and shall inform the Board
Wednesday (D+5) Payment Date	<ul style="list-style-type: none"> CDCP SR: Distribution date (distribution of instruments resulting from the conversion) – CDCP shall inform the Board CDCP SR: commencement of real-time settlement

7. Issuance of New Shares

The specifics of the issue of new shares are described in the Council's decision. The process starts with the communication of the institution with the CDCP SR regarding the issuance of new ISINs.

The following steps are executed by the respective counterparties – in this case the CDCP SR:

- The owners of the converted instruments and creditors of the converted liabilities that were affected are given newly issued shares in the nominal amount based on the recapitalisation amount set to ensure the institution's continued operations and the conversion rate set in the decision based on Valuation 2.
- The CDCP SR is responsible for implementation of the relevant changes, including the distribution of the shares to the entitled recipients (in accordance with the instruments, amounts and conversion rates specified in the decision).
- Identification of the recipients of the allocation are based on data obtained. The accounts for registration of the newly issued shares can be identified by the CDCP SR when making changes to reflect the conversion of the instruments and liabilities. Where necessary, the new owner's account might be established within the CDCP SR (in some cases by the respective designated member – in most cases the institution itself).
- The requirements arising from the application of an anti-money laundering framework for documentation of the identification of a client could be temporarily suspended (if the

requirement for setting a new account is made by the Council, applying the provisions in Art.9(2) of ZORKS. Once such a suspension is lifted, information for the proper identification could be provided either by the institution itself, the new owners or could be derived from previously obtained documentation for new owners who have already held an account.

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.

WDCI is carried out by the institution based on the information in the Council's decision and in line with its bail-in playbook, including instructions to CDCP SR and paying agents to implement the reduction of CET1 items and the write-down and conversion of eligible instruments and liabilities. As summarised in Table 1, the institution completes the forms needed for the corporate actions related to WDCI, submits them to CDCP SR and informs the Council. CDCP SR must execute these actions and notify the Council by 20:00 on the following day. The bail-in playbook outlines the full procedure, allocates responsibilities and tasks, and sets out the information exchange with all relevant third parties to ensure proper implementation of the resolution decision.

The CDCP is responsible for implementing the relevant changes, including the distribution of the shares to the entitled recipients. 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. Conversion of interim instruments

Slovak law does not regulate interim instruments for addressing differences between the provisional and final Valuation 2. The closest instrument that could be used for this purpose is an investment certificate issued under Section 4a of the Securities Act. Although this option is not free of legal risk, it currently appears to be the only practicable solution, though it may be offered only to Professional Clients. Such certificates would need to be issued alongside shares and specify their future conversion based on the definitive Valuation 2.

This approach may be relevant if only the provisional version of Valuation 2 is available, the definitive version is not expected within a reasonable timeframe, and the SRB might require corrective measures. Investment certificates would provide flexibility to adjust outcomes later without immediately changing the allocation of shares among converted creditors.

Initially, shares would be issued based on the provisional Valuation 2 to meet recapitalisation needs and recorded in accounts under § 150a of the Securities Act. At the same time, investment certificates linked to these shares would be issued to converted creditors on a 1:1 basis. Their maturity would coincide with the availability of the definitive Valuation 2, which would determine the final conversion rate. If the final valuation shows lower losses, a write-up of liabilities would correct the overly conservative provisional estimate. To facilitate later adjustments, it is recommended that shares be issued with a low nominal value.

10. 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.