

Information on creditor participation (“bail-in”) in bank resolution and recovery proceedings

To create a common European framework of rules and instruments for the recovery and resolution of banks, the EU issued a directive (Bank Recovery and Resolution Directive (BRRD)) establishing a framework for the recovery and resolution of credit institutions and investment firms. This directive was transposed into Austrian law as **Bundesgesetz über die Sanierung und Abwicklung von Banken (BaSAG, Federal Act on the Recovery and Resolution of Banks)**.

The Federal Act on the Recovery and Resolution of Banks (BaSAG) governs a number of different aspects, including the participation of a bank’s creditors (bail-in) in a bank’s resolution under prudential supervision. The purpose is to prevent the use of taxpayers’ money when a bank risks defaulting.

When a bank is at risk of failing, the competent resolution authority may apply a number of resolution tools:

Sale of business

All or part of a bank’s assets and/or liabilities are transferred to a buyer. For the bank’s clients and creditors this translates into a change in their contracting partner or debtor.

Bridge institution

A public-sector institution takes over the liabilities and/or assets of the bank undergoing resolution. For the bank’s clients and creditors this again translates into a change of their contracting partner/debtor.

Asset separation

This is the so-called bad bank mechanism. The assets and/or liabilities of the bank concerned are transferred to special-purpose vehicles for deleveraging. For clients and creditors this again translates into a change of their contracting partner/debtor.

Bail-in

When an authority orders the resolution of a bank, the bank’s equity and debt is written down in whole or in part or converted into equity. The purpose of this approach is to stabilise the bank affected. In such a case, shareholders and creditors may have to bear substantial losses as the resolution authority may reduce their claims, without their consent, in the extreme case even to zero.

Resolution authorities exercise the power to write down or convert relevant instruments in the following order:

1. shares and other equity instruments (Common Equity Tier-1 capital – “CET 1” and additional Tier-1 capital – “AT1”)
2. subordinated liabilities (e.g. supplementary and junior bonds – “Tier 2”)
3. uncovered subordinated financial instruments/claims that are not part of additional Tier 1 or supplementary capital (“Tier 2”)
4. uncovered non-subordinated financial instruments and claims (e.g. uncovered bank bonds and certificates)
5. lastly, deposits of enterprises and natural persons not covered by the deposit guarantee scheme

Exempted from bail-in are deposits subject to the deposit guarantee scheme as well as covered bank bonds (“covered bonds” or mortgage bonds) and separate assets (e.g. investment funds).

The BRRD rules have been implemented in the laws of member states across Europe. Bail-in may thus also be applied to bank bonds from other EU countries, for example, although the details of the rules may differ at national level.

Risk disclosure:

For a bank’s creditors, the bail-in proceedings described above which are provided for by the law may lead to a total loss of the capital invested. In recovery and resolution proceedings, the sale of bonds, for example, may become more difficult and possible only with a substantial loss in value. Even if the original issuing document or marketing material of a bank product does not specifically describe the bail-in option, the product may be affected by a bail-in under the law.

Further information can be found on the following web pages:

Austrian National Bank (OeNB):
<https://www.oenb.at/en/financial-market/three-pillars-banking-union/single-resolution-mechanism.html>
 Austrian Financial Market Authority (FMA):
<https://www.fma.gv.at/en/bank-resolution/>