

# Information on Bank Resolution and Bail-In

H2 2023

## 1.1 Introduction

- a) In order to avert a bank resolution using public funds, the European and German legislator have adopted the following legislation:
  - Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 (the “**BRR Directive**”) to provide authorities with comprehensive and effective arrangements to deal with failing banks at national level and cooperation arrangements to tackle cross-border banking failures;
  - Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 (the “**SRM Regulation**”) establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund;
  - German Act on Restructuring and Resolution (*Sanierungs- und Abwicklungsgesetz* “**SAG**”), transposing the BRR Directive into German law and applying to entities not falling within the scope of the SRM Regulation.
- b) The above legislation introduces a variety of measures for an orderly resolution in the event of distress. The resolution authorities having the power to order any resolution measures are the German Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht* – “**BaFin**”) as the competent national authority in Germany, as well as the Single Resolution Board (“**SRB**”) for institutions falling within the scope of the SRM Regulation.
- c) In order for BaFin or, as the case may be, the SRB to order a resolution measure, the following criteria must be met:
  - The respective bank’s existence is at risk;
  - There is no prospect of averting the bank’s failure by alternative private sector measures or other measures of the competent supervisory authorities;
  - The respective resolution measure must be necessary and proportionate, whereby regular insolvency proceedings over the bank’s assets are not an equivalent alternative.
- d) The resolution measures BaFin, or as the case may be, the SRB may take, include:
  - **Bail in:** writing down some or all of the financial instruments issued by a bank or contractual payment claims against a bank as well as conversion thereof into bank’s equity (shares or other company interests);
  - **Sale:** sale of some or all of the shares, assets, rights and/or liabilities of the bank to a certain buyer;
  - **Transfer to bridge institution:** transfer of shares in the bank or some or all of the bank’s assets, including its liabilities, to a so-called ‘bridge institution’ (“*Brückeninstitut*”);
  - **Asset separation:** the assets, rights or liabilities of the bank are transferred to a separate asset management vehicle;
  - **Amendments of terms and conditions:** by means of an executive order, amendment of terms and conditions of financial instruments issued by the bank and of creditors’ claims, such as due dates, interest rates, suspension of termination rights to the disadvantage of the bank’s respective counterparty.
- e) The extent to which (if at all) creditors are affected by the aforementioned measures is dependent on the scope of the specific measure and on the classification of the financial instrument held by the respective creditor. Financial instruments and claims are placed into different categories, whereby the order in which these categories are used for the purpose of a resolution is defined by statutory law (“liability cascade” or “*Haftungskaskade*”).
- f) In general, any higher category in the bank’s liabilities as set out in the liability cascade below must first be fully exhausted to offset losses. Only if, after exhausting such higher category, the bank is still not stabilised, the lower category may be used to stabilise the bank. In individual cases, BaFin or, as the case may be, the SRB may deviate from this order of priority.

- g) For banks based in Germany, the liability cascade is as set forth below. For the purpose of this document, “**CRR**” means Regulation (EU) 575/2013 of the European Parliament and of the Council of 26 June 2013:
- **First**, shares and other Common Equity Tier 1 (CET) instruments as defined in the CRR;
  - **Second**, additional Tier 1 instruments (AT1) as defined in the CRR (with its nominal or outstanding amount, i.e. inclusive of any amounts which ceased to be recognised for prudential purposes pursuant to Art. 484 et. seqq. CRR), meaning unsecured, perpetual subordinated debt securities with a conversion or write-down clause;
  - **Third**, Tier 2 instruments (T2) as defined in the CRR (with its nominal or outstanding amount, i.e. inclusive of any amounts which ceased to be recognised for prudential purposes pursuant to Art. 64 CRR (Amortisation of Tier 2 instruments) or pursuant to Art. 484 et seqq. CRR), meaning subordinated loans, subordinated silent partnerships and subordinated participation rights;
  - **Fourth**, unsecured subordinated liabilities, meaning subordinated loans, subordinated bearer bonds, subordinated participation rights, in each case not meeting the requirements for AT1 or T2 instruments;
  - **Fifth**, liabilities from unsecured non-subordinated (cf. section 38 of the German Insolvency Code Insolvenzordnung – “**InsO**”) and non-structured debt instruments (section 46f (6) and (9) of the German Banking Act Kreditwesengesetz – “**KWG**”) – also referred as „Non-preferred-senior-bonds”. This category includes:
    - i) bearer bonds and order bonds **issued since 21 July 2018**, which have a contractual maturity of at least one year, are not structured products and point out in their contractual terms and in case of an obligation to publish a prospectus also in the prospectus the lower rank in insolvency proceedings pursuant to section 46f (5) KWG; and
    - ii) Promissory note loans (*Schuldscheindarlehen*) and registered bonds (*Namensschuldverschreibungen*), which meet the conditions for bearer bonds and order bonds as mentioned above, as far as these (promissory note loans and registered bonds) do not qualify as preferred deposits according to item **Seventh** below or are excluded from write-down and conversion as covered deposits (cf. item **First** of the subsequent table for instruments which are excluded from write-down and conversion under Section 1 (h) below).
  - **Sixth**, unsecured non-subordinated (cf. section 38 InsO) liabilities (not debt instruments within the meaning of section 46f (6) KWG; cf. section 46f (6) sentence 3 and section 46f (7) KWG). This category includes:
    - i) bearer bonds and order bonds issued since 21 July 2018 with a contractual maturity of at least one year, which are not structured products, provided that in their contractual terms and in case of an obligation to publish a prospectus also in the prospectus a lower rank in insolvency proceedings pursuant to section 46f (5) KWG is not pointed out;
    - ii) money market instruments;
    - iii) structured debt instruments (i.e. bonds with a derivative component, in which the repayment or interest payment is dependent on an uncertain future event, e.g. index certificates);
    - iv) debt instruments of institutions under public law which cannot become insolvent;
    - v) futures contracts, options, swaps;
    - vi) Deposits which are not “covered deposits” (for “covered deposits” see item **First** of the subsequent table for instruments which are excluded from write-down and conversion under Section 1(h) below) and not “preferred deposits” pursuant to item **Seventh** hereof

(as long as they are not promissory note loans or registered bonds, in which case they fall under item **Fifth** hereof):

- deposit amounts exceeding 100,000 euros from large corporate undertakings,
  - non-refundable deposits pursuant to section 6 of the German Deposits Protection Act (*Einlagensicherungsgesetz*) (e.g. deposits from public bodies, insurance undertakings, financial institutions and credit institutions, as far as the latter do not fall under item **Fifth** of the subsequent table for instruments which are excluded from write-down and conversion under Section 1(h) below).
- vii) Liabilities to customers from the banks' lending business, for example from guarantee business, documentary credit transactions or credit business.
- **Seventh**, preferred deposits, meaning Deposits from private individuals, micro-entities and small and medium-sized entities, in respect of amounts, which are not "covered" (for "covered" amounts see item **First** of the subsequent table for instruments which are excluded from write-down and conversion under Section 1(h) below), i.e. amounts exceeding 100,000 euros.
- h) The following instruments are exempt from write-down or conversion:
- **First**, covered deposits, meaning deposits (including time and notice deposits and savings account deposits) for amounts of up to 100,000 euros;
  - **Second**, secured liabilities, meaning covered bonds, in particular *Pfandbriefe*, secured loans or derivatives;
  - **Third**, liabilities resulting from the safekeeping of client assets or client money, meaning assets of private and corporate customers managed or held for investment purposes;
  - **Fourth**, liabilities resulting from a fiduciary relationship, meaning pass-through loans, syndicate business;
  - **Fifth**, liabilities owed to other credit institutions, with an original term of less than seven days;
  - **Sixth**, liabilities with a remaining maturity of less than seven days, owed to payment systems, securities delivery and settlement systems or to operators and other participants of such systems, if those liabilities result from the participation in the system;
  - **Seventh**, liabilities owed to:
    - i) employees, for accrued salary, pension benefits;
    - ii) commercial or trade creditors arising from the provision to the institution or group entity of goods or services that are critical to the ongoing functioning of its operations; and
    - iii) deposit guarantee schemes based on contribution obligations.
- i) In the event that BaFin, or as the case may be, the SRB orders the above resolution measures, shareholders or creditors may suffer a partial or total loss on their investment. In addition, the mere option of resolution measures being administered may result in creditors having to sell their financial instruments at a substantial discount, thus leading to a loss on their initial investment.
- j) Resolution measures may not lead to shareholders having a worse position than under normal insolvency proceedings over the bank's assets. In the event that a shareholder or creditor is worse off than it would have been under regular insolvency proceedings, then it would be entitled to a compensation from the fund for resolution purposes (either the restructuring fund ("Restrukturierungsfonds") or the Single Resolution Fund.

## 1.2 Regulatory Disclosure

- a) Certain financial instruments issued by credit institutions and investment firms are used to comply with regulatory capital requirements pursuant to the CRR, as well as Directive 2013/36/EU and Directive 2014/59/EU. Such financial instruments include, in particular:
  - i) CET1 (Section 1.1(g), item **First** above);
  - ii) AT1 (Section 1.1(g), item **Second** above);
  - iii) T2 (Section 1.1(g), item **Third** above);
  - iv) the subordinated liabilities set forth in under Section 1.1(g), item **Fourth** above; and
  - v) the liabilities set forth under Section 1.1(g), item **Fifth** above.
- b) These instruments generally offer a greater return than bank deposits. However, such instruments are exposed to greater risk of default, such as in the event of insolvency proceedings or the administration of the aforementioned resolution measures. As opposed to bank deposits, such instruments can in principle be traded, however finding a buyer or a seller on the secondary market may prove impossible. In addition, the price at which such instruments can be sold may significantly drop to the disadvantage of the respective investor, as a result of which an investor may suffer a partial or total loss on its investment.
- c) Detailed information on the risks of a specific financial instrument will be provided to you in the product documentation concerning each such financial instrument.
- d) For more information on the resolution of banks, please refer to the internet presence of BaFin under the following link:

[https://www.bafin.de/EN/Aufsicht/BankenFinanzdienstleister/Massnahmen/SanierungAbwicklung/sanierung\\_abwicklung\\_node\\_en.html;jsessionid=D9318B7738F2FFA135BF67518499530A.1\\_cid390](https://www.bafin.de/EN/Aufsicht/BankenFinanzdienstleister/Massnahmen/SanierungAbwicklung/sanierung_abwicklung_node_en.html;jsessionid=D9318B7738F2FFA135BF67518499530A.1_cid390)

