

Quadrilateral 2016

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The Financial Markets Law Committee

The Financial Markets Lawyers Group

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The Financial Law Board

Registered Charity Number: 1164902.

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Ending “Too Big To Fail” Bank Structural Reform

Chair: Dr Joanna Perkins, FMLC

Olivier Coupard, Credit Agricole (EFMLG)

BANK STRUCTURAL REFORM

Olivier Coupard

Crédit Agricole Corporate & Investment Bank

INTRODUCTION

On 19 June 2015, the Council agreed its negotiating stance on structural measures to improve the resilience of EU credit institutions.

The proposal is aimed at strengthening financial stability by **protecting the deposit-taking business** of the largest and most complex EU banks from potentially risky trading activities. The proposed regulation would apply only to **banks that are either deemed of global systemic importance or exceed certain thresholds** in terms of trading activity or absolute size. Despite recent regulatory reforms in the banking sector, these credit institutions and groups remain **too-big-to-fail**, too-big-to-save and too complex to manage, supervise and resolve.

LIIKANEN REPORT

The draft regulation builds on the recommendations of a report published in October 2012 by a "high-level group" chaired by the governor of the Bank of Finland, Erkki Liikanen (the "Liikanen report").

The regulation requires a **qualified majority** for adoption by the Council, in agreement with the European Parliament. (Legal basis: Article 114 of the Treaty on the Functioning of the EU.)

TACKLING EXCESSIVE RISKS

The draft regulation is intended to reduce excessive risk taking and prevent rapid balance sheet growth as a result of trading activities. It sets out to shield institutions carrying out activities that deserve a public safety net from losses incurred as a result of other activities. It provides for the **mandatory separation of proprietary trading** and related trading activities and establishes a framework for competent authorities to take measures to reduce excessive risk taking.

Trading activities other than proprietary trading would be subject to a risk assessment. If a competent authority finds that an excessive risk exists, it could require trading activities to be separated from the core credit institution, or demand an increase in the core credit institution's own fund requirements, or impose other prudential measures. Trading entities would be prohibited from taking retail deposits eligible for deposit insurance.

SCOPE

According to the Council's text, the regulation would apply to global systemically important institutions (in accordance with directive 2013/36/EU on capital requirements) or to entities with total assets of at least €30bn over the last three years and trading activities of at least €70 billion or 10% of their total assets. These banks would be allocated into **two tiers**, depending on whether the sum of their trading activities during the last three years exceeds €100 billion or not. Stricter reporting requirements, a more thorough risk assessment, and different supervisory actions would apply to banks exceeding the threshold.

The regulation would not apply to institutions with total eligible deposits (under directive 2014/49/EU on deposit guarantee schemes) of less than 3% of their total assets, or total eligible retail deposits of less than €35bn.

As proposed by the Commission, it would also not apply to sovereign debt instruments. But in the Council's text, a review clause has been further elaborated to specify that the Commission would review this exclusion taking into account developments at European and international level.

NATIONAL REGIMES

To accommodate existing national regimes, the Council text provides **two options** for addressing excessive risk stemming from trading activities: This could be done either through national legislation requiring core retail activities to be ring-fenced, or through measures imposed by competent authorities in accordance with the regulation.

Ending “Too Big To Fail”

Living Wills and Resolution Planning

Chair: Joanna Perkins, FMLC

Locke McMurray, Jones Day (FMLG)

Resolution Strategies and Financing in Resolution

Habib Motani, Clifford Chance (FMLC)

Financing in Resolution

“Everybody needs money. That’s why they call it money.”

Mickey Bergman (Danny De Vito) in *The Heist*

Financing in Resolution

FSB Resolvability Assessment Process found funding to be key impediment to G-SIB resolvability. Risk of insufficient liquidity to continue critical functions in resolution.

2015 FSB consultation on guiding principles (consistent with FSB Key Attributes for effective resolution) on temporary funding of firms in resolution.

Recapitalisation (via bail-in etc.) is not the full picture. Even a successfully recapitalized firm may face liquidity stress.

FSB proposed guiding principles focus on:

1. Ways to encourage and maintain as much private sector funding as possible to the firm in resolution;
2. The role and types of public sector backstop mechanisms for providing temporary liquidity to the extent necessary to support the orderly resolution of a G-SIB; and
3. Elements of public sector backstop mechanisms that support the minimisation of moral hazard risks.

FSB guiding principles on funding G-SIBs in resolution

Rely on private sources of funding as first choice

- Sources of private sector liquidity might take form of *private consortiums* (counterparties pool resources and risk) or *super priority* (debtor in possession style) financing from banks, private equity and hedge funds. Historically, no precedent of DIP financing in a G-SIB resolution.
- Presence of public sector backstop guarantees may be necessary to encourage private sector to provide financing.

Have an effective public sector liquidity backstop

- May take form of resolution funds, deposit insurance funds, resolution authorities, central banks and/or finance ministries.
- Recapitalized firm in resolution should retain access to normal central bank liquidity if it meets the access conditions. Access to ordinary central bank liquidity may be pre-condition to maintaining payment and settlement system access in some jurisdictions.
- Presence of effective public sector backstop promotes market confidence and orderly resolution. To support critical functions in resolution public backstops should be appropriate in terms of:
 1. Size – large enough to support resolution of multiple G-SIBs simultaneously
 2. Timing – funds rapidly available once firm in resolution and may be needed intra-day for payments / settlements
 3. Term – long enough to enable the G-SIB to regain access to private sources of liquidity

FSB guiding principles on funding G-SIBs in resolution (continued)

Strict conditions on public funding to reduce moral hazard

- Public funding poses potential moral hazard. Terms of funding should mitigate this through:
 1. Access conditions – Firm must be solvent / recapitalized first
 2. Subject firm to heightened supervision when drawing on public backstop
 3. Term – no longer than necessary to enable firm to regain access to private sources of funding
 4. Collateral haircuts – if line is collateralized
 5. Pricing – should incentivize use of private sources of funding
 6. Exit incentives – to encourage early return to private sources of funding

Subject to NCWO safeguard, public sector losses should be recoverable from shareholders / unsecured creditors

- Features of public sector backstops should enable recovery of losses from shareholders, unsecured creditors or from surviving banks / wider financial system. Recouping public losses from private sector subject to NCWO safeguard.

FSB guiding principles on funding G-SIBs in resolution (continued)

Importance of a sound and feasible resolution plan

- Credibility of resolution plan key to attracting private sources of funding. Resolution authorities need to communicate action plan effectively to restore market confidence when resolution begins.
- Liquidity planning and collateral availability key factor of resolution plan and resolvability assessment.
- Resolution plan should outline funding strategy in resolution, identify high quality liquid assets that could be used to collateralize lines, consider different currency requirements, expected sources of private / public funding

Home and host state cooperation

- Home-host cooperation and information key to assess group wide risks. Enables host authority to understand how group liquidity profile affects establishment in the host jurisdiction.
- Resolution strategy will define respective roles of home / host:
 - Single point of entry: home authority exercises resolution tools and coordinates liquidity provision
 - Multiple point of entry: each host authority responsible for resolving an entity in its jurisdiction responsible for liquidity to that part of group

Ending “Too Big To Fail” Loss Absorbing Capacity

Chair: Dr Joanna Perkins, FMLC

Dr Joanna Perkins, FMLC

Masaru Itatani, Bank of Japan (FLB)

Loss-Absorbing Capacity and Bank Capital



Dr Joanna Perkins, Chief Executive, FMLC

Registered Charity Number: 1164902.

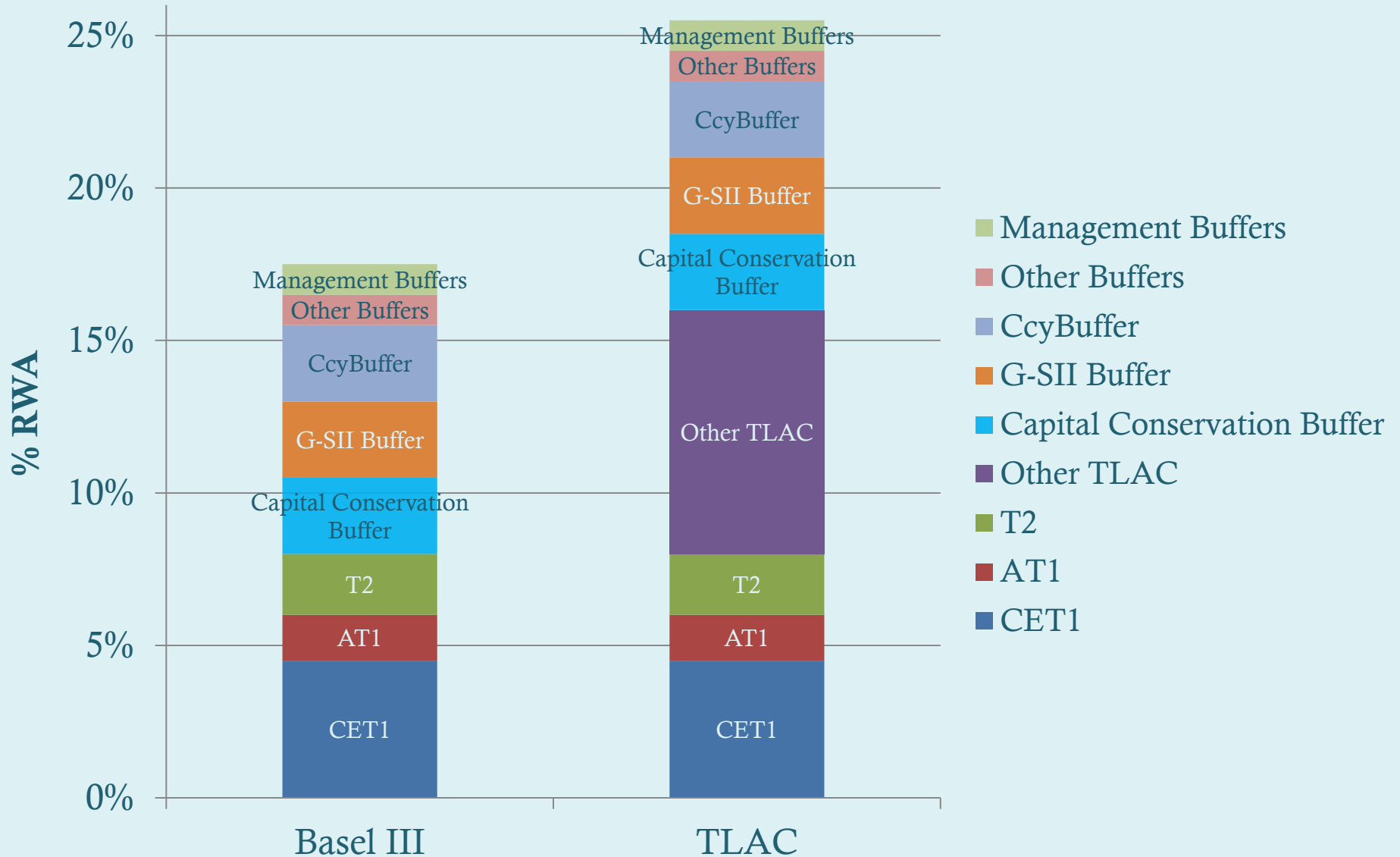
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A glossary

•	AT1	Additional Tier 1 Capital
•	BRRD	Bank Recovery and Resolution Directive
•	CET1	Common Equity Tier 1 Capital
•	CCyB	Counter-cyclical buffer
•	FSB	Financial Stability Board
•	EBA	European Banking Authority
•	GLAC	Gone Concern Loss Absorbing Capital
•	CoCos	Contingent Convertible Capital Instruments
•	G-SIB or G-SII	Global Systemically Important Bank/Institution
•	LR	Leverage Ratio
•	LRE	Leverage Ratio Exposure
•	LTD	Long Term Debt
•	MREL	Minimum Requirement for Eligible Liabilities
•	PONV	Point of Non-Viability
•	RTS	Regulatory Technical Standards
•	RWA	Risk Weighted Assets
•	SPOE	Single Point of Entry (a resolution strategy applied to Holdco)
•	SRB	Single Resolution Board
•	TLAC	Total Loss Absorbing Capacity
•	T2	Tier 2 Capital

Going concern capital and loss absorbing capital – a comparison



A resolvable bank...

What does it look like?

1. Meets Basel III Capital Requirements and/or provides early warning of potential breach.
2. Susceptible to recapitalisation at PONV:
 - Reserve capital sufficient to replenish CET1 after write down
 - Additional loss-absorbing capital sufficient to replenish reserve capital after conversion
3. Can be placed in cross-border resolution without fragmentation:
 - Parent company invests in reserve capital of bank subsidiary
 - Individual subsidiaries to meet minimum capital requirements at all times
4. Constructive market certainty about recapitalisation:
 - Capital liabilities contractually subordinate to senior liabilities, operating liabilities and deposits
5. Access to further liquidity
 - Possible bail-in of additional liabilities etc
 - Bridge bank likely to benefit from improved credit conditions
 - Pre-funding commitments

Regulating for loss absorption—a timeline

- **2009**
 - G20 Finance Ministers commit to introducing new regulation on bank capital and bank resolution
- **2013**
 - G20 leaders call on the FSB to develop proposals by end-2014 on the adequacy of global systemically important financial institutions' loss-absorbing capacity
- **2014**
 - EU BRRD establishes rules for MREL
 - FSB publishes proposal for TLAC guidelines
- **2015**
 - FSB publishes final term-sheet for TLAC and Impact Assessment Study
 - EBA publishes Draft RTS on MREL criteria under BRRD
 - Federal Reserve issues rules on TLAC for U.S. G-SIBs and intermediate Holdcos of foreign banks
 - Bank of England and PRA publish proposals for setting MREL and combining MREL with capital requirements—BoE proposes to incorporate TLAC requirements for UK G-SIBs
- **2016**
 - SRB presents MREL methodology
 - EBA publishes opinion rejecting amendments to Draft RTS on MREL criteria
 - EU Commission explores "appropriate ways to transpose the FSB's TLAC standard into EU law in a manner that articulates well with existing MREL and capital requirements".
 - EU Commission adopts Delegated Regulation on RTS for MREL criteria and methodology

Loss-absorbing criteria...

TLAC (for G-SIBs) according to the FSB

- 16% RWA from 2019, rising to 18% by 2022
 - LRE Minimum = 6% LR denominator, rising to 6.75%
 - Possible additional firm-specific requirements
 - No double accounting with CET1 capital buffers
 - Eligible instruments: paid-in, unsecured, not subject to set-off or netting, maturity of 1 yr+, not subject to acceleration or early redemption, not issued intra-group (unless internal TLAC).
 - Does not include excluded instruments, e.g. structured notes
 - Subordinated liabilities only.
 - Write-down/bail-in must be legally enforceable under governing law
 - 75-90% **internal** TLAC requirement for “material” subsidiaries
- N. B. (1) *The FSB takes the view that a breach of TLAC requirements should have the same consequence as a breach of Basel III capital requirements, i.e. the institution has reached the point of non-viability and should be placed into resolution.*
- (2) *The impact study published by the FSB indicates that 29 G-SIBs had average TLAC ratio of 13.1% of RWA in 2014. This indicates a global shortfall of €307 to €790 billion, depending on which instruments are considered (or, if excluding emerging market G-SIBs, of €42bn to €520bn).*

Loss-absorbing criteria...

MREL according to the EU

Article 45 Bank Recovery Resolution Directive:

- MREL applies to all banks, not just G-SIBs
- Calculated as % of total liabilities (not RWA)
- Appropriate level MREL to be tailored to each institution by competent authority
- Eligible instruments: paid-up, not self-referencing (e.g. as guarantor), maturity of 1 yr+, not arising from a derivative or a preferred deposit.
- Write-down must be enforceable under governing law and, for “contractual bail-in instruments”, provided for in the contract
- Subordinated liabilities only

Commission Delegated Regulation on Regulatory Technical Standards (May 2016)

MREL must cover, at least:

- capital requirements and a corresponding recapitalisation amount

Loss-absorbing criteria...

LTD according to the Federal Reserve

- Contingent capital is not currently required to be held by financial institutions or bank holding companies in the United States
- G-SIBs will, however, be required to hold LTD or $> 6\%$ RWA and $> 4.5\%$ LR denominator.
- They will also be required to meet strict TLAC requirements:
 - 18% RWA
 - LRE Minimum = 9.5% LR denominator
- Eligible external LTD instruments prohibited from: (a) Being structured notes; (b) having a credit-sensitive feature; (c) including a contractual provision for conversion into or exchange for equity in the covered BHC; or (d) including a provision that gives the holder a contractual right to accelerate payment (including automatic acceleration),

N. B. *There are two routes to resolution in the U.S.—by the Orderly Liquidation Authority (i.e. the FDIC) under Title II of Dodd Frank Act and under the Bankruptcy Code (which is preferred). “Living wills” for resolution under the Bankruptcy Code are required under Title I of Dodd Frank and focus on either the “SPOE” or “Bridge Bank” options for G-SIBs. There are differences across all these routes but none contemplates bail-in as a significant resolution strategy and all focus on sale, transfer or restructuring of viable businesses and liquidation of any “rump”. The Hoover Resolution Project has proposed a new “Chapter 14” to the US Bankruptcy Code which would (in their view) facilitate the SPOE approach under the Code.*

Conclusion

- Conclusions



Market for the TLAC instruments - Between Scylla and Charybdis

July 20, 2016
Masaru Itatani
Bank of Japan

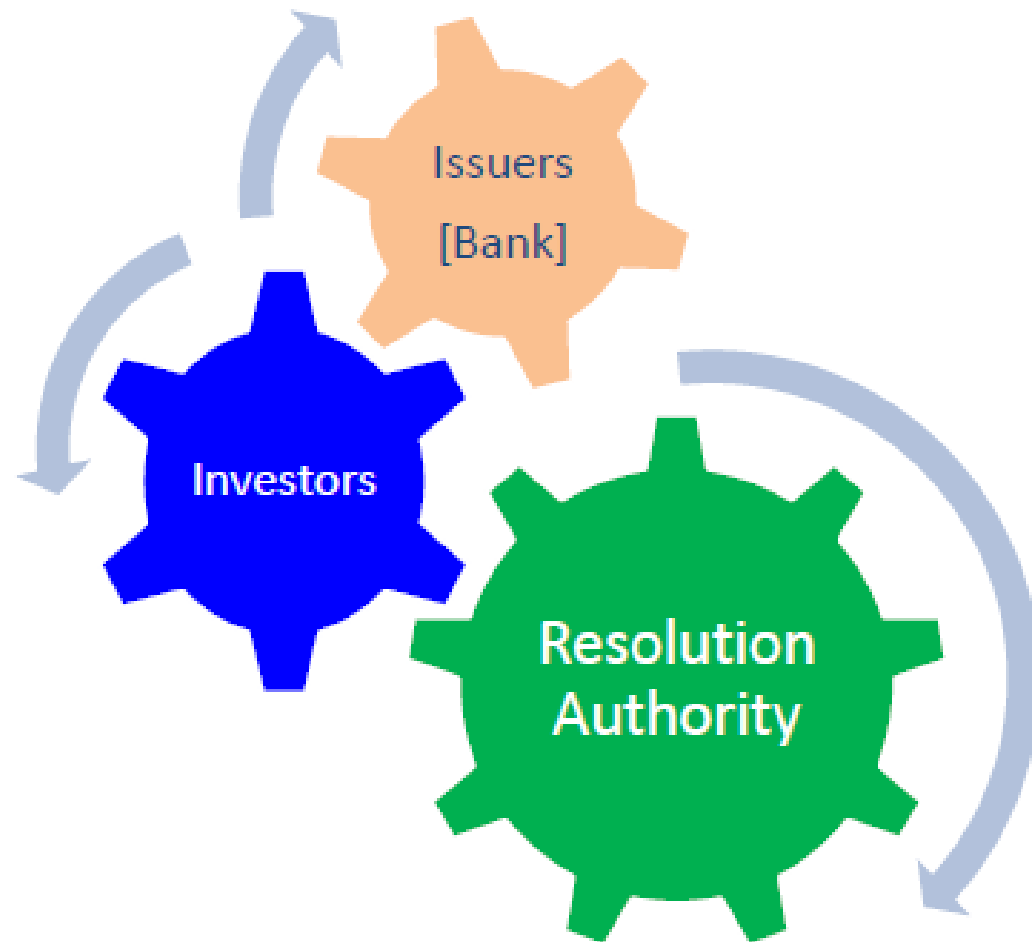
Instruments exacerbate stressed market conditions?

A catch 22 situation may emerge, when

- TLAC instruments infiltrate a wide investor pool
- But under stressed market conditions, TLAC instruments become an additional source of destabilization (despite FSB Principle vii*).
 - In crises, *the banking industry as a whole* tends to face selling pressure.
 - Investors try to dispose of the instruments linked to the credit risk of banks.

* “(a) authorities must be confident that the holders of (TLAC) instruments are able to absorb losses in a time of stress in the financial markets without spreading contagion and without necessitating the allocation of loss to liabilities where that would cause disruption to critical functions or significant financial instability.”

Successful TLAC regime builds on three components



Prospective Investors for TLAC instruments

Fast Money

- Hedge Funds
- Active Funds
- Securities Firms

Real Money

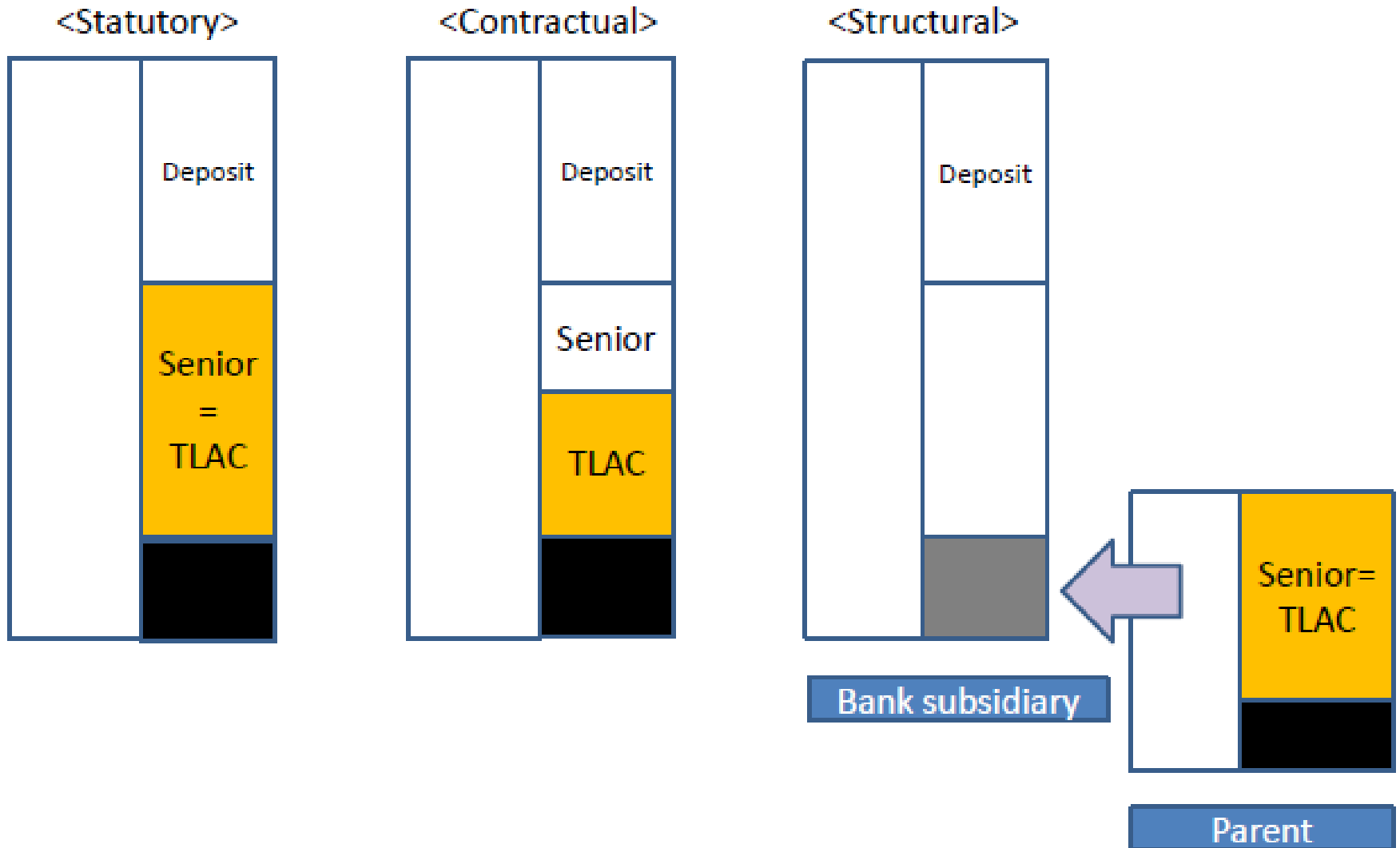
- Pensions
- Insurance
- Mutual Funds
- Banks

Retail Investors

- Mutual Funds

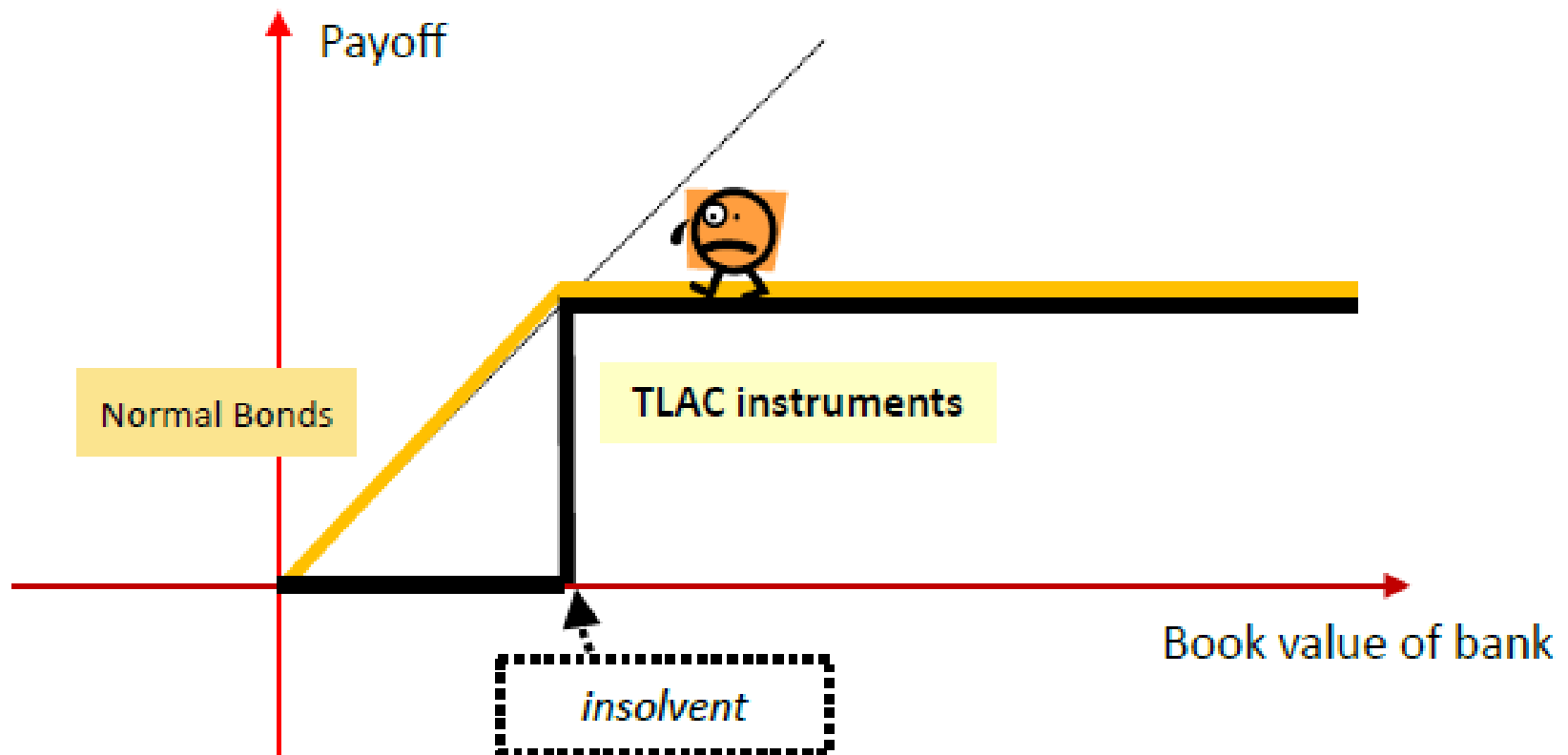
Preferable!

TLAC instruments in the pecking order

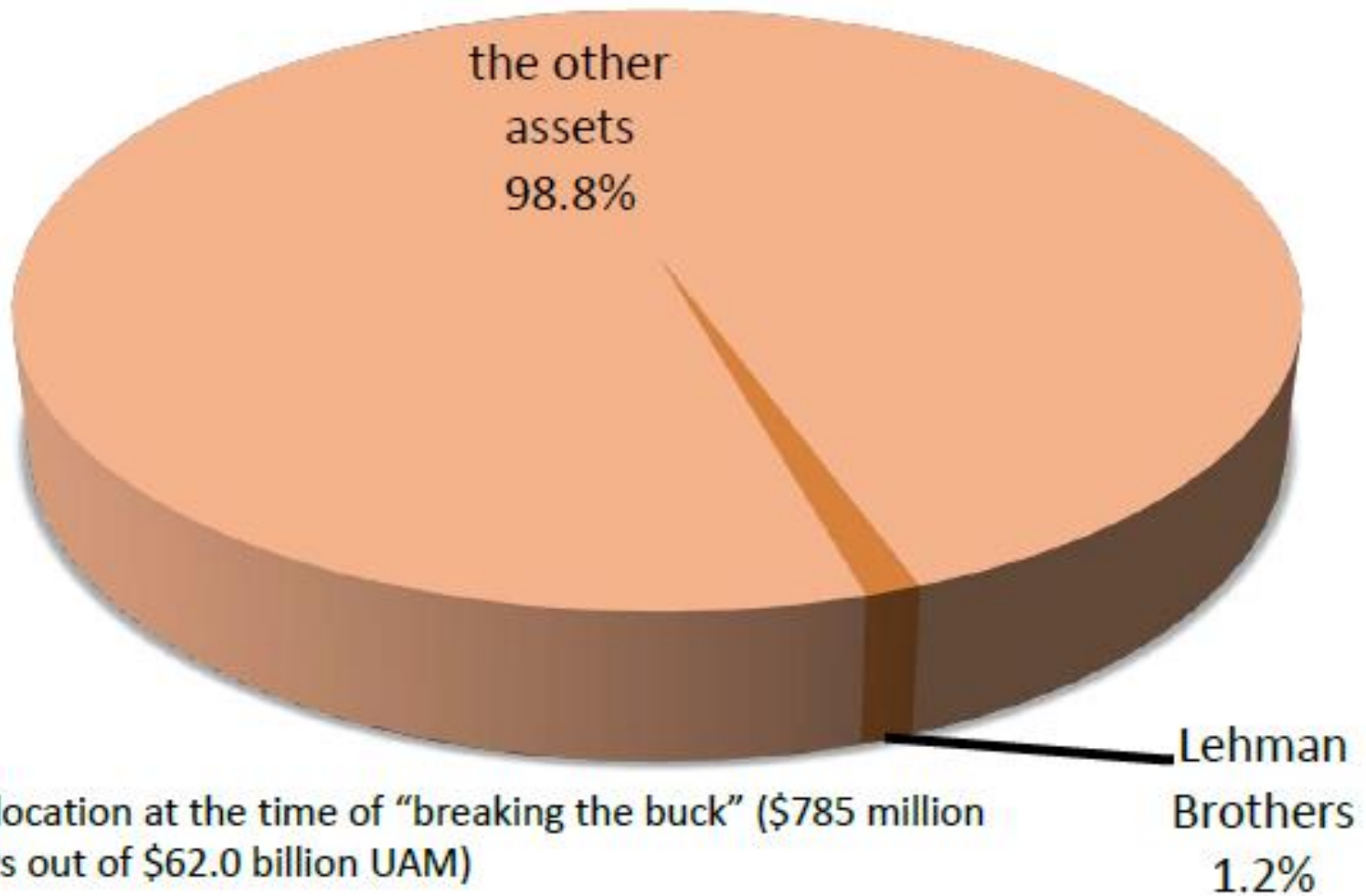


Payoff diagram of TLAC instruments

- In return of higher coupon, TLAC instrument holders have a chance to face “cliff” loss.



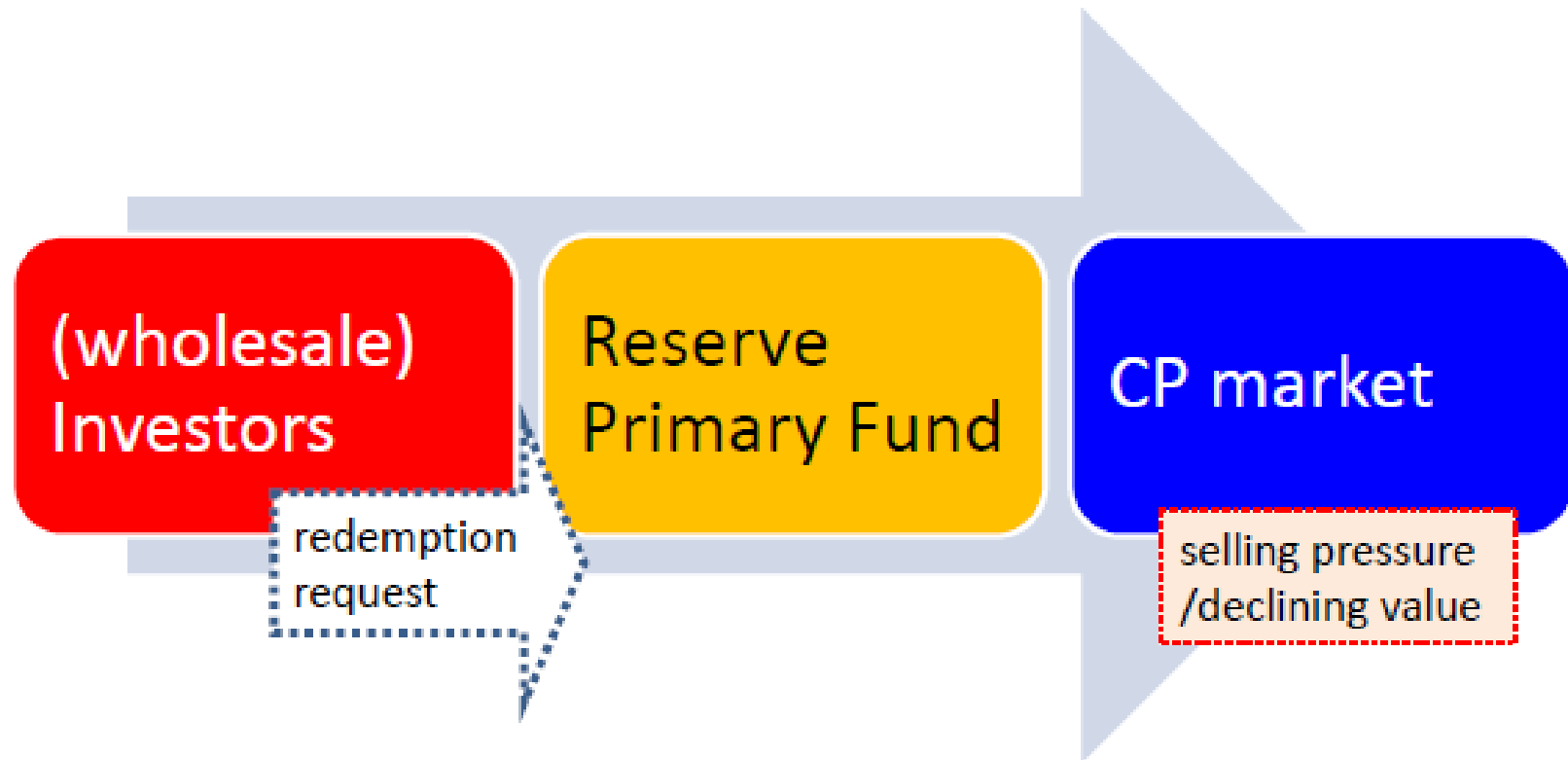
Case study 1: Reserve Primary Fund



Asset allocation at the time of "breaking the buck" (\$785 million of LB CPs out of \$62.0 billion UAM)

Case study 1: Reserve Primary Fund (cont'd)

- Savvy investors “run” within HOURS, not days.



Case study 1: Reserve Primary Fund (cont'd)

- Some improvements on the side of MMFs.
 - ◆ United States
 - SEC revised the investment company act and require all the primary fund to employ floating NAV and redemption restrictions.
 - ◆ Europe
 - European Authority revised the rule in the same line with the U.S.

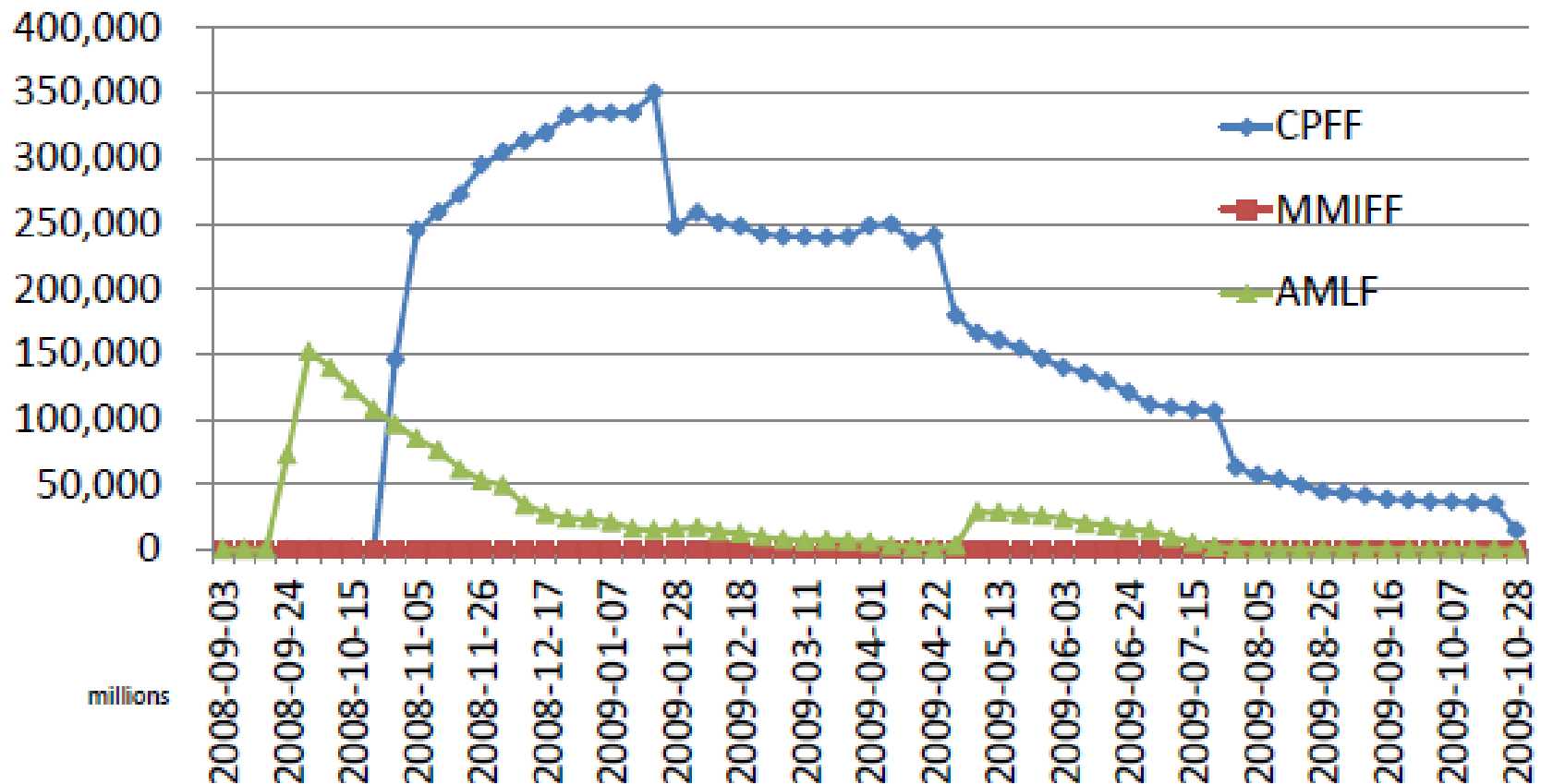
It will certainly reduce the risk of “run,” but will not eliminate it altogether. (eg. maturity mismatch, procyclical redemption)

Case study 2: MMIFF

- The Federal Reserve Bank of New York (NY Fed) created the Money Market Investor Funding Facility (MMIFF) in October 2008 to support a private-sector initiative designed to provide liquidity to **U.S. money market investors**.
- Under the MMIFF, NY Fed provided senior secured funding to a series of special purpose vehicles to facilitate an industry-supported private-sector initiative to finance the purchase of eligible assets from eligible investors.
- The MMIFF commenced on November 24, 2008 and expired on October 30, 2009.

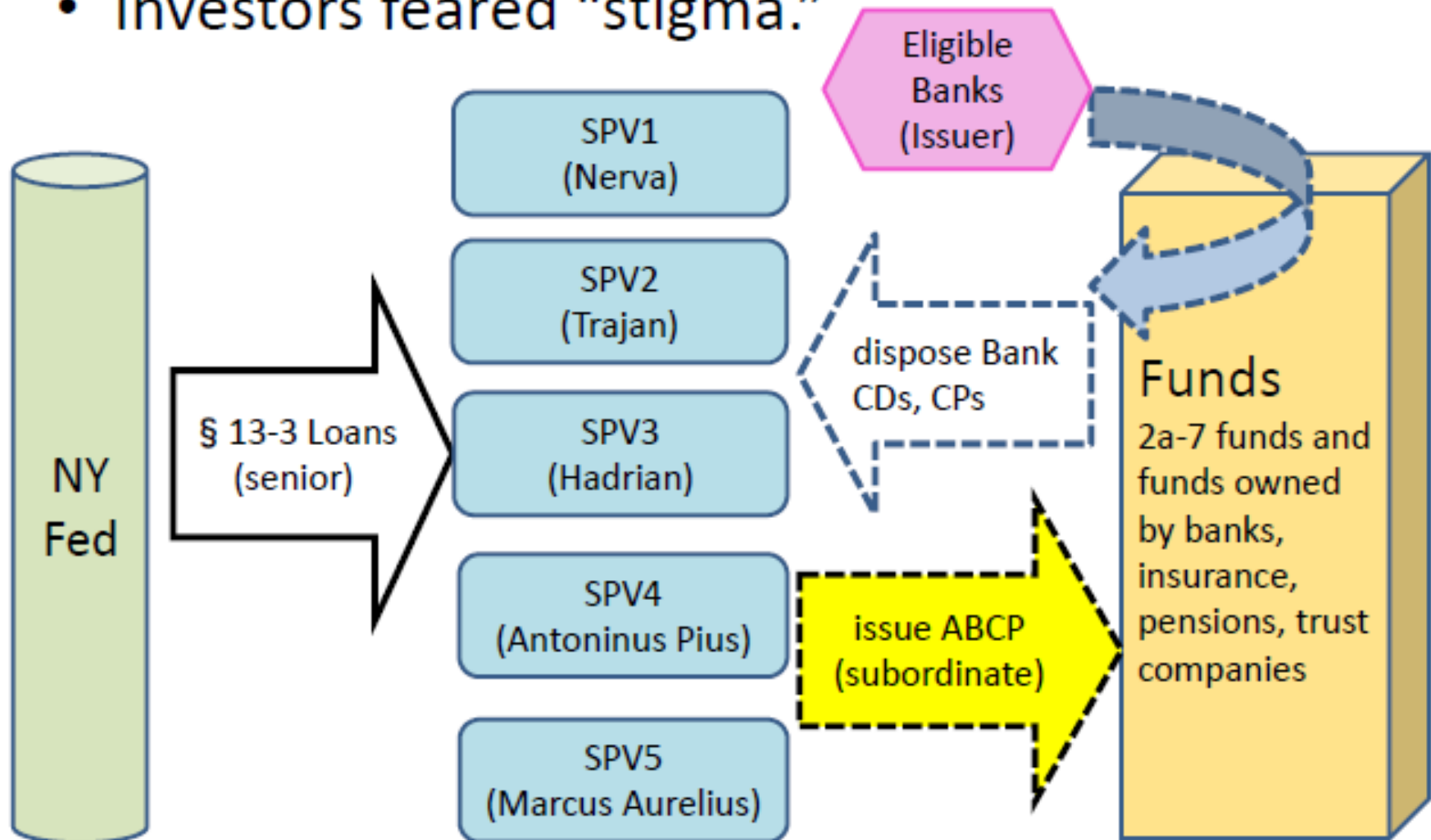
Case study 2: MMIFF (cont'd)

- Never used, while sister facilities recorded quite a high demand.



Case study 2: MMIFF (cont'd)



- Investors feared “stigma.”



Case study 3: Bond mutual fund redemption

- Recent study has found that asset managers sell more of the underlying assets than is necessary to meet redemptions by ultimate investors, because they try to hoard cash in anticipation of further redemptions.
- These additional, discretionary sales may exacerbate the selling pressures in a run like episode.
 - “Investor redemptions and fund manager sales of emerging market bonds: how are they related?”
(Jimmy Shek, Ilhyock Shim and Hyun Song Shin, BIS Working Papers, No. 509, 2015)

Conclusion: Central Banks come to rescue again?

- Price of the TLAC instruments may move in the same direction.
 - A G-SIB is in trouble 
 - The other (seemingly sound?) G-SIBs 
- Central banks may again need to support the market.
 - otherwise, G-SIBs are not able to satisfy the TLAC requirement?

* Despite Section 9 of the FSB Term Sheet (“(t)he appropriate authority should ensure that the maturity profile of a G-SIB’s TLAC is adequate to ensure that its TLAC position can be maintained should the G-SIB’s access to capital markets be temporarily impaired”). See also Section 6.

Ending “Too Big To Fail”

Bail-in, Write Down and Conversion

Chair: Otto Heinz, European Central Bank
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SOCIETE GENERALE PRESENTATION

A comparative approach to the bail-in hierarchy in the EU

Asmaa CHEIKH

Director

LEGAL DEPARTMENT – FINANCIAL AND BANKING REGULATIONS

21 JULY 2016

A comparative approach to the bail-in hierarchy in the EU

AGENDA

- Loss absorbing capacity and bail-in
- MREL rules
- TLAC rules
- BRRD : write down hierarchy waterfall
- Hierarchy in Germany
- Hierarchy in France
- Hierarchy in Italy
- Hierarchy in Spain
- Hierarchy in the UK



Introduction - Loss absorbing capacity and bail-in

1/3

- On 1 January 2015, the EU Bank Recovery and Resolution Directive (« BRRD ») took effect
- The Directive provides a comprehensive framework for the orderly resolution of failing banks within the EU
- One objective of this framework is to shift the burden of bank rescues from taxpayers to bank creditors. To that end, resolution authorities are given the power to allocate losses to shareholders and certain creditors, according to a sequence of write down and conversion as per article 48 BRRD:
 - « Losses should first be absorbed by regulatory capital instruments and should be allocated to shareholders. If regulatory capital instruments are not sufficient, subordinated debt should be converted or written down. Senior liabilities should be converted or written down if the subordinate classes have been converted or written down entirely »
- **Bail-in tool:**
 - The bail-in tool enables to absorb losses (by write down) and recreate regulatory own funds (by conversion into equity)
 - The tool had to be implemented no later than 1 January 2016, although earlier application was possible
 - The tool applies to all liabilities that are not exempt (e.g. covered deposits, secured liabilities including covered bonds)
 - Safeguards: Resolution Authorities should apply the bail-in tool in a way that respects the pari-passu treatment of creditors, the statutory ranking of claims under the applicable insolvency law and the « no creditor worse off than in liquidation» (« NCWOL »)
- In order to facilitate the application of the bail-in tool, prevent disputes based on the NCWOL principle, and as a consequence easy comply with MREL/TLAC, several EU member states have adopted legislative reforms affecting among others things, insolvency laws to amend the hierarchy of creditors' claims in the insolvency of credit institutions
- Hence, the insolvency hierarchy of certain liabilities (particularly senior unsecured debt, derivatives, bank deposits etc.) varies across EU member states
- The EU has started working on a possible harmonization of hierarchy for all EU banks.

Introduction: MREL

2/3

To ensure the effectiveness of the bail-in tool and that upon resolution, a failing institution holds sufficient amount of bail-inable liabilities, the BRRD establishes that the institution meet at all times a minimum requirements for own funds and eligible liabilities (« MREL ») to be determined by the resolution authority (discretionary ratio).

- This is a key requirement for the credibility of the bail-in tool, applicable to all EU Credit institutions and Investment firms in scope.
- The BRRD lists a number of conditions for the eligibility of certain liabilities for MREL including limitations as to the maturity (remaining maturity of at least one year), the holder (instrument issued and fully paid up, not owned, secured nor guaranteed by the institution, and purchase of the instrument not funded directly or indirectly by the institution) and the nature (the liability does not arise from a derivative or from a preferred deposits)
- Instruments do not need to be subordinated to count to MREL but resolution authority may require contractual bail-in instruments (ie. instruments subject to subordination and containing contractual terms providing for their conversion or write down upon resolution)
- Instruments which are not eligible for MREL are not necessarily excluded from bail-in. Therefore a number of instruments will absorb losses in line with their ranking in the hierarchy of creditors albeit they do not count toward the MREL
- The UK has proposed an approach to MREL relying on structural subordination. Debt issued by holdco would be bailed-in first. In continental EU, the larger majority of banks do not have holdings and the creation of holdings may be lengthy, expensive and even impossible for legal reasons
- MREL should be amended due to transposition of TLAC in EU law.

Introduction: TLAC

3/3

- The Financial Stability Board (FSB) published on 9 November 2015 a new standard on Total Loss Absorbing Capacity (TLAC). This standard shares the same objective as the MREL (i.e. to reduce the impact of banking failures on public funds) but applies to all Global Systematically Important Banks (GSIBs) worldwide.
- FSB recommendations are not legally binding unless they are implemented in local laws. The US has already consulted on its implementation. The EU is still working on a text that could be released end of this year (before the usual trilogue process between Commission, Parliament and Council).
- The TLAC standard provides that instruments must be subordinated to any excluded liabilities except an allowance of 5% of total TLAC debts that can be pari-passu with TLAC debts.
- Three kinds of subordination are foreseen in the TLAC standard:

Structural subordination

Whereby the instrument is issued by a resolution entity which does not have any excluded liability ranking pari-passu or junior to TLAC-eligible instruments

Contractual subordination

Whereby a contractual clause makes the instrument junior to excluded liabilities on the balance sheet of the resolution entity

Statutory subordination

Whereby the instrument is by law (statutory creditor hierarchy) junior to excluded liabilities on the balance sheet of the resolution entity

Therefore it only applies to 13 banking groups within the EU (See EGOV briefing PE 574.406 GSIBs in Europe)

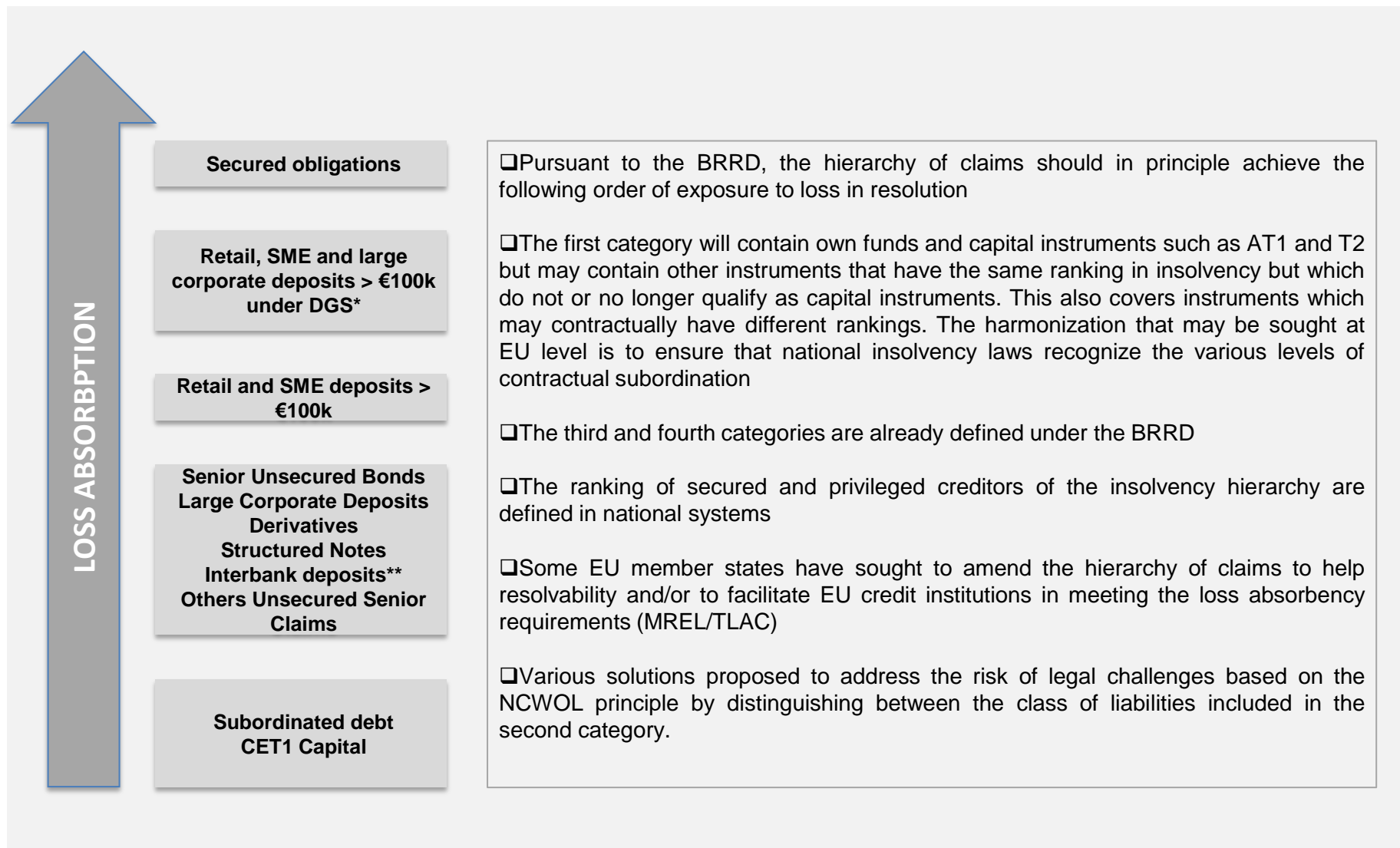
Liabilities excluded from TLAC are : insured deposits, short term deposits, liabilities arising from derivatives, debt instruments with derivatives-linked features, preferred liabilities to senior unsecured liabilities under the relevant insolvency laws and any liability which cannot be bailed-in without giving rise to material risk of successful legal challenges

BRRD

Write down hierarchy waterfall

*The EU Directive 2014/49/EU on Deposit Guarantee schemes

** BRRD Exemption : > 7 days

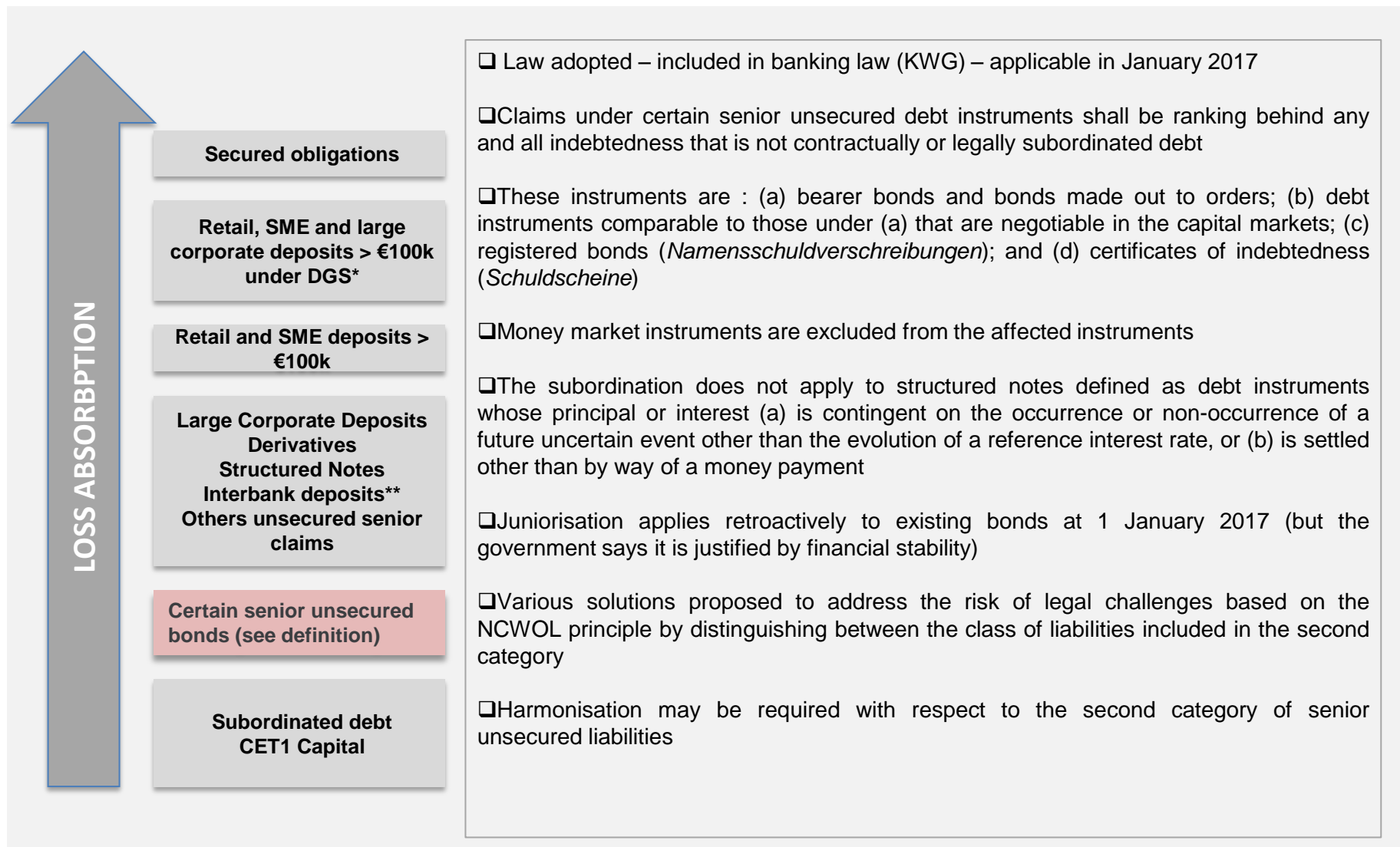


GERMANY

Write down hierarchy / waterfall

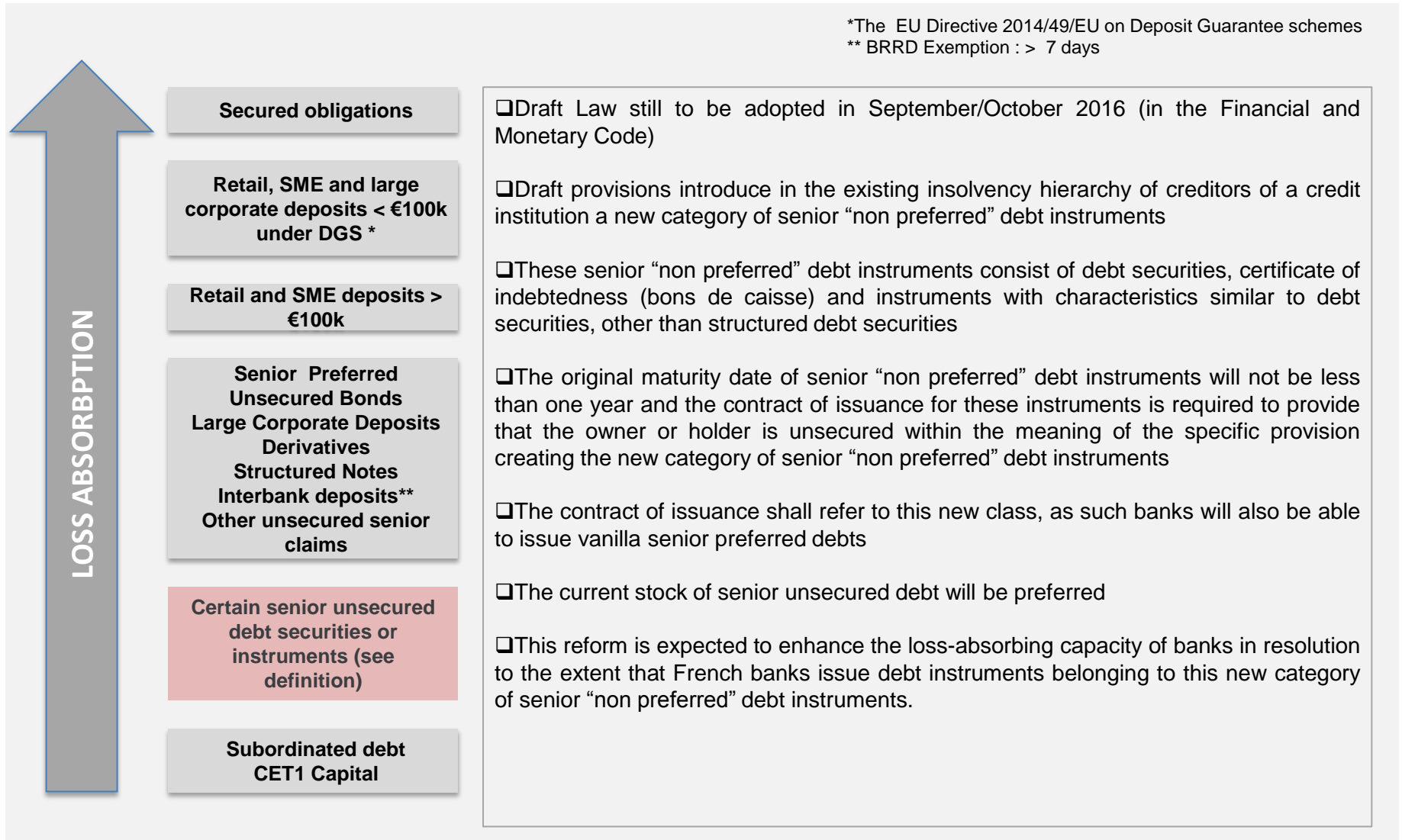
*The EU Directive 2014/49/EU on Deposit Guarantee schemes

** BRRD Exemption : > 7 days



FRANCE

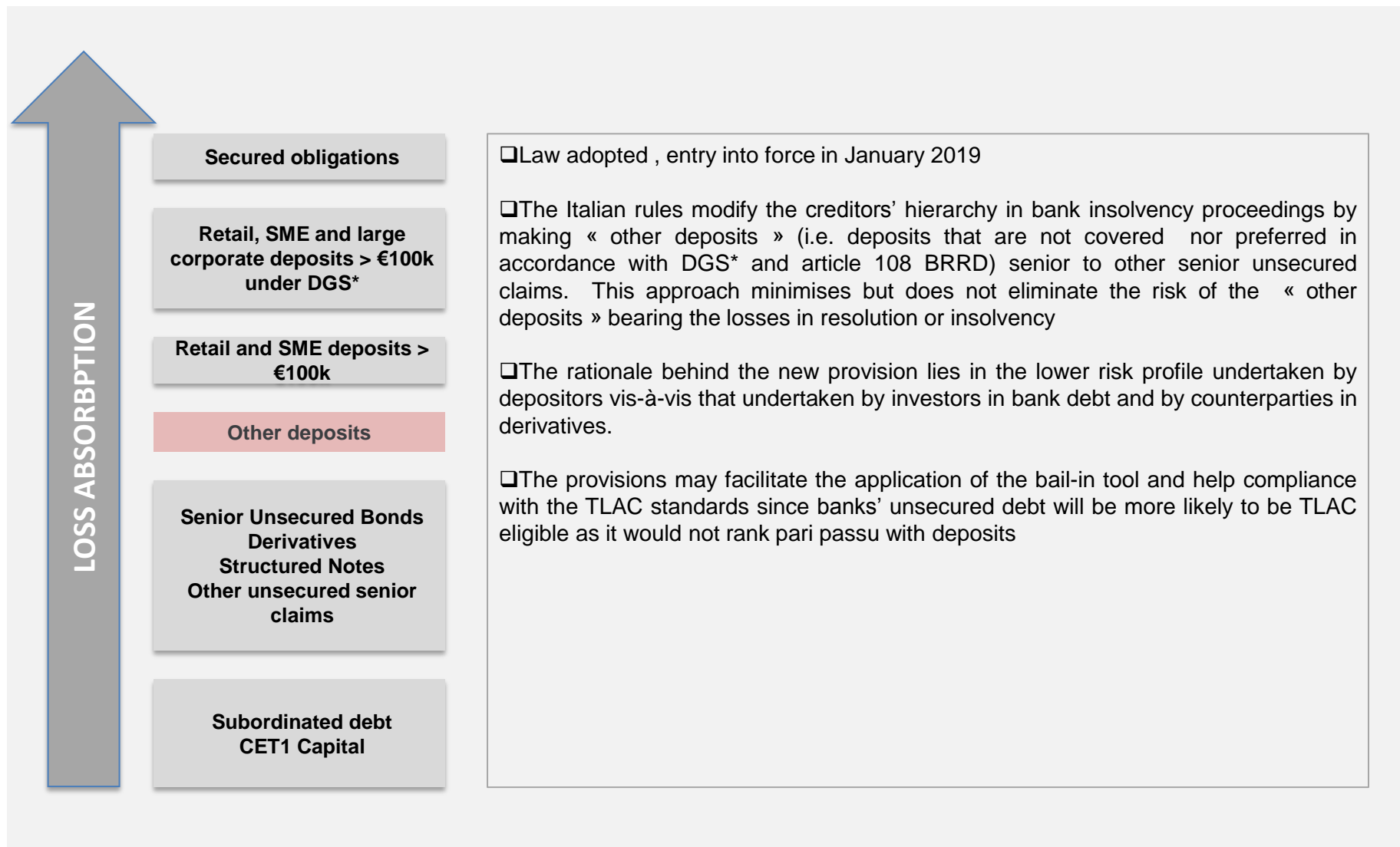
Creation of a new asset class of senior unsecured debt securities or instruments



ITALY

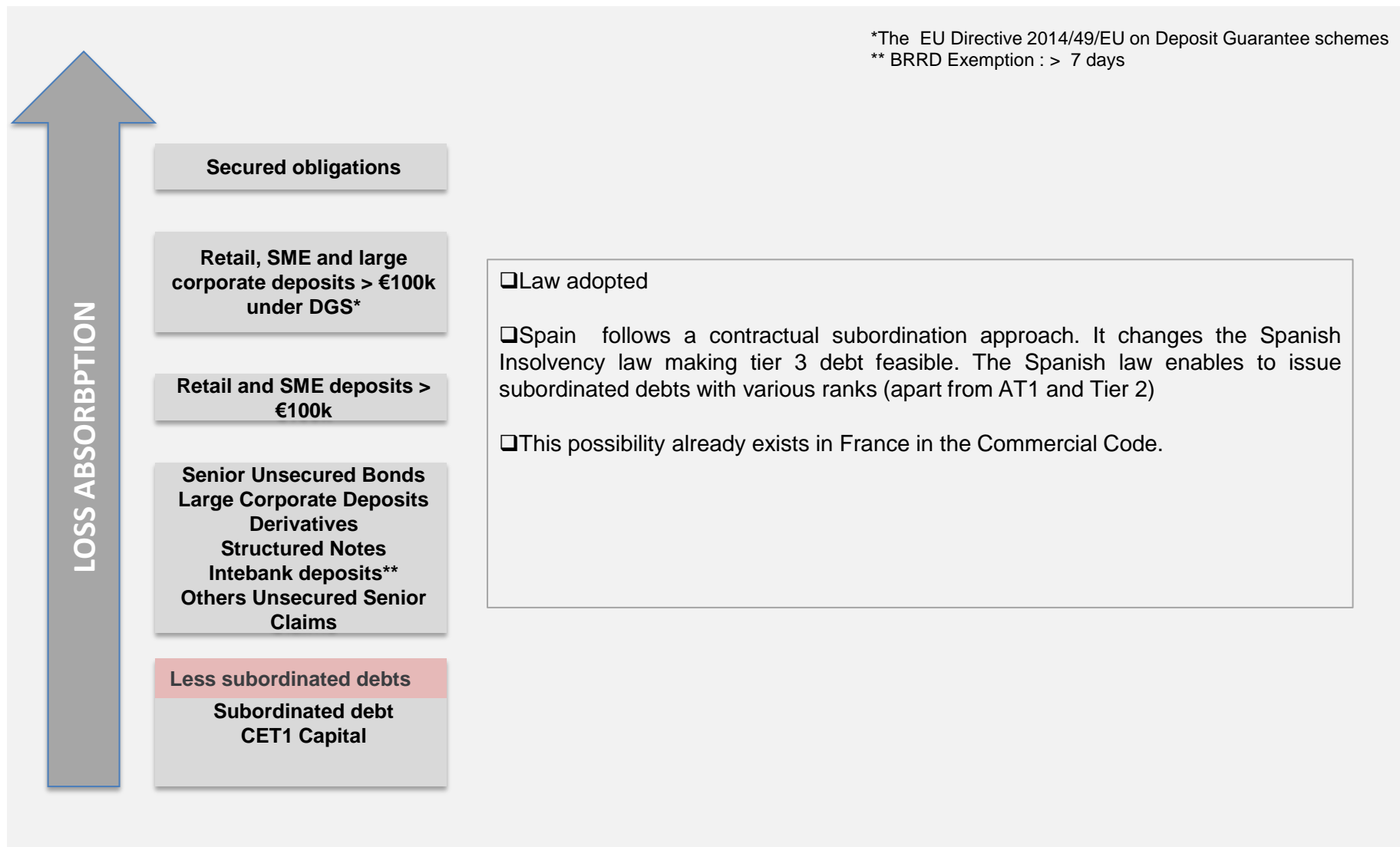
Super seniority of « other deposits »

*The EU Directive 2014/49/EU on Deposit Guarantee schemes



SPAIN

Creation of a new asset class



❑ Holdco structure

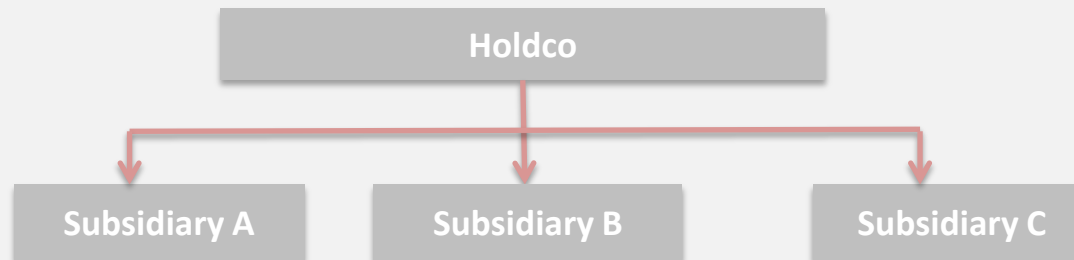
- The assets of the Holdco consist of the equity of its operational subsidiaries (e.g. bank)
- The liabilities of the subsidiaries, in turn, consist of the debt issued to outside investors and the equity held by the Holdco

❑ Banks with a Holdco structure most often have implemented a single point-of-entry (SPE) concept. SPE refers to the Holdco being the relevant balance sheet for all bail-in activities of the group

❑ Consultation of BOE on MREL :Banks for which bail-in is the chosen resolution strategy will generally be required to raise MREL resources at their holding company and downstream it in the form of capital or another form of subordinated claim to material operating subsidiaries. In this way, the MREL liabilities will be 'structurally subordinated' to senior liabilities of operating companies

❑ The creditors of the Holdco bear a share of the losses of a subsidiary, allowing the entire group to be recapitalized

❑ No matter where the subsidiaries (operating companies, Opcos) are located, losses at their level are channelled to the Holdco. The Holdco then settles with its shareholders (write down of equity) and with its debt-holders (write down or conversion of debt)



THANK YOU

Ending “Too Big To Fail”

Bail-in, Write Down and Conversion

Habib Motani, Clifford Chance LLP (FMLC)

Requirements for Valuations in connection with resolution exercises under BRRD

- Before taking resolution action or exercising power to write-down or convert, resolution authorities to ensure an independent valuation of the assets and liabilities (Article 36(1) BRRD)
- May be a provisional valuation, in which case to be followed by ex-post definitive valuation as soon as possible (Article 36(10))
- Distinct ex-post valuation under Article 74 to feed into NCWO determination

Valuation of Derivatives (Article 49)

- Write-down and conversion of derivatives only after close-out of the derivatives
- Resolution authority empowered to terminate and close out
- Where netting agreement, liability for write-down and conversion purposes of derivatives to be determined on a net basis
- Principles to be determined for valuation

RTS – Methodology and Principles on valuation of derivatives (May 2016)

- Prior to exercising write-down and conversion powers resolution authority to notify counterparties
- Specify date and time by when counterparties to provide evidence of “commercially reasonable replacement trades for the purpose of determining the close-out amount” (Article 3)
- Where counterparty provides evidence, valuer to determine close-out amount at those prices (Article 6)
- Where counterparty not provided evidence (or valuer determines the replacement trades not on commercially reasonable terms) valuer to determine close-out amount on basis of
 - Mid-market end of day prices
 - mid to bid spread or mid to offer spread
 - adjustments to above to reflect liquidity and size of exposure
- Valuer may consider data that is observable data or theoretical prices sourced from 3rd party sources, quotes, CCP values, valuation models

Point in time for establishing value (Article 8)

- Where counterparty provided good evidence of replacement trades, date of the replacement trade
- Where CCP determined early termination amount, date when it did so
- Otherwise close-out date (or if not commercially reasonable) date when market price available

Comparison of destruction in value from close-out versus bail-in potential (Article 2)

- Resolution authority to compare the losses that would be borne on a bail-in by the derivatives against potential destruction in value expected from close-out
- Comparison to be made before decision to close-out and to inform decision on resolution action to be taken

Ending “Too Big To Fail”

Bail-in, Write Down and Conversion

Masaru Itatani, Bank of Japan (FLB)

ARTICLE 55 OF THE BRRD AND THE DEVELOPMENTS

Olivier Coupard

Crédit Agricole Corporate & Investment Bank

ARTICLE 55

Contractual recognition of bail-in

1. Member States shall require institutions and entities referred to in points (b), (c) and (d) of Article 1(1) to include a contractual term by which the creditor or party to the agreement creating the liability recognises that liability may be subject to the write-down and conversion powers and agrees to be bound by any reduction of the principal or outstanding amount due, conversion or cancellation that is effected by the exercise of those powers by a resolution authority, provided that such liability is:

- (a) not excluded under Article 44(2);
- (b) not a deposit referred to in point (a) of Article 108;
- (c) governed by the law of a third country; and
- (d) issued or entered into after the date on which a Member State applies the provisions adopted in order to transpose this Section.

The first subparagraph shall not apply where the resolution authority of a Member State determines that the liabilities or instruments referred to in the first subparagraph can be subject to write down and conversion powers by the resolution authority of a Member State pursuant to the law of the third country or to a binding agreement concluded with that third country.

Member States shall ensure that resolution authorities may require institutions and entities referred to in points (b), (c) and (d) of Article 1(1) to provide authorities with a legal opinion relating to the legal enforceability and effectiveness of such a term.

ARTICLE 55 CONTINUED.....

2. If an institution or entity referred to in point (b), (c) or (d) of Article 1(1) fails to include in the contractual provisions governing a relevant liability a term required in accordance paragraph 1, that failure shall not prevent the resolution authority from exercising the write down and conversion powers in relation to that liability.

3. EBA developed draft regulatory technical standards in order to further determine the list of liabilities to which the exclusion in paragraph 1 applies, and the contents of the term required in that paragraph, taking into account banks' different business models. EBA submitted those draft regulatory technical standards to the Commission. Power is delegated to the Commission who adopted the regulatory technical standards referred to in the first subparagraph in accordance with Articles 10 to 14 of Regulation (EU) No 1093/2010 and which were published at the EU Official Journal in July 2016.

Ending “Too Big To Fail”

Bail-in, Write Down and Conversion

Caroline Boon, Barclays (EFMLG)

Brexit

Chair: Lord Walker, FMLC

Caroline Boon, Barclays (EFMLG)

Michel Petite, Clifford Chance LLP (FMLC Guest)

Kate Gibbons, Clifford Chance LLP (FMLC)

Brexit

English Law after the EU Referendum

Kate Gibbons, Clifford Chance LLP (FMLC)

English Law after the EU Referendum

- English law – not a Swiss Cheese, but a complete, coherent functioning legal system both before and after 23 June and before and after and departure of the UK from the EU.
- EU law has not changed in any significant way those aspects of English law relating to transactions and contract law.
- English choice of law
- Submission to the jurisdiction of the English courts
- English legal opinions