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Position of the European Financial Congress[1] in relation to the Financial Stability Board's consultative document on Principles on Bail-in Execution [2]

Methodology for preparing the answers

The answers were prepared in four stages:

Stage 1

A group of experts from the Polish financial sector were invited to participate in the survey. They received selected extracts of the consultative document as well as the consultation questions in Polish. The experts were guaranteed anonymity.

Stage 2

The European Financial Congress received over 20 opinions from key financial market institutions in Poland and from individual experts. All the responses were collected, anonymised and presented to the experts who took part in the consultation. The experts were asked to mark in the other consultation participants' opinions the passages that should be included in the final position as well as the passages they did not agree with. Experts could also adjust their own positions under the influence of arguments presented by other experts they had not known previously.

Responses were obtained from:

- banks,
- regulatory bodies,
- law firms,
- the academia.

Stage 3

The survey project coordinators from the European Financial Congress prepared a draft synthesis of opinions submitted by the experts. The draft synthesis was sent to the experts participating in the survey with the request to propose modifications.

Stage 4

On the basis of the responses received, the survey project coordinators from the European Financial Congress prepared the final version of the European Financial Congress' answers presented below.

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[1] European Financial Congress (EFC – www.efcongress.com). The purpose of the regular debates held within the EFC Project is to ensure the financial security of the European Union and Poland.

[2] http://www.fsb.org/wp-content/uploads/P301117-1.pdf

Answers of the European Financial Congress to the consultation questions

Q 1. Do the principles in the draft guidance address all relevant aspects of a bail-in transaction, including cross-border aspects? What other aspects, if any, should be considered?

The principles contained in the draft guidance address most relevant aspects of a bail-in transaction, but need to be supplemented.

Bail-in involves far-reaching interference with the right to own property; this is controversial and may be challenged. Therefore, the effectiveness of bail-in will depend to a large extent on the stability and indisputability of both the legal framework and the operational application of this tool. It would therefore be beneficial to define *ex ante*, in as much detail as possible, coherent and comprehensive rules that would be applicable to bail-in implementation.

The principles completely overlook social impact. It is true that the document allows for "Discretionary exclusion from bail-in", but only "in exceptional cases", and this thread should be elaborated upon in more detail in the regulations. A social impact index should be developed for the bail-in mechanism and where the structure of creditors is such that the haircut would largely affect households, this mechanism should apply to shareholders only. In the case of institutional creditors, this mechanism could be applied in the manner provided for in statutes.

The document does not address the possibility of a contagion effect which could be triggered following the bail-in and which is of particular importance for the stability of the entire financial system. It appears that this issue could be elaborated upon in the context of possible exclusions from the scope of bail-in or conversion (Principle 2).

Apart from organisational and technical issues, however, we must remember that the possibility of resorting to the bail-in mechanism depends on the buffers of liabilities held by the bank that may be bailed in or converted. This issue is particularly important in the cross-border dimension. The success of the entire resolution process will depend on the determination of the appropriate level of TLAC (MREL) at subsidiaries and parent undertakings. However, this problem has not been addressed in the document. Although the FSB refers to it in other guidance, we are of the opinion that the document being currently drawn up should also address this problem.

The availability of bail-in instruments to special entities in which the Treasury holds a stake should also be taken into account as well as the restrictions related to legal requirements that protect the stake held by the Treasury, and the prohibitions on bailing in and on the disposal of the shares held.

The solutions proposed with respect to burden sharing in the case of cross-border banks are insufficient. This aspect is particularly important for Poland.

Another vital issue for Poland is the potential liquidity drain between countries – within banking groups that have subsidiaries in different jurisdictions. Events similar to those that took place during the 2007–2010 crisis may still occur.

In the case of SPoE, bail-in instruments should probably be agreed between the resolution authority conducting the process for the group in question and the local authorities at a sufficiently early stage. Incidentally, a bail-in of corporate deposits may be insignificant

from the point of view of a group (e.g. in the European market) but still very significant in some local market where it may cause a local systemic crisis.

In addition, given the certain degree of discretion afforded to resolution authorities when dealing with institutions on the verge of bankruptcy, it cannot be ruled out that the existing bail-in mechanisms will require separate interpretation on a case-by-case basis due to specific circumstances. Such a situation occurred in relation to some Italian banks such as Banca Monte dei Paschi di Siena, which had a certain number of retail investors among its creditors. In our opinion, the greatest challenge to the harmonisation of rules in all jurisdictions is the need to define uniform rules of conduct, e.g. determining the minimum unit nominal value of a bail-in instrument in order to protect retail investors while at the same time adjusting these rules to specific characteristics of individual markets and the level of their development.

It appears that national resolution authorities should draw up, preferably in consultation with national supervisory authorities:

– standards/guidelines for conducting valuations in the process of bailing in or converting equity instruments; and

– qualification requirements for valuers (entities) that are authorised to conduct such valuations.

Other important elements appear to be training and stress testing of valuation procedures for the purposes of the bail-in process.

While conducting bail-in processes for SIBs with an international reach, it will also be necessary to coordinate the work of teams of valuers; it should be ensured that experts in different countries rely on identical, uniform valuation standards and apply a single methodology to assets or instruments subject to valuation so that the *pari passu* principle is properly observed in all countries included in the resolution procedure for the SIB in question.

Q 2. Should any of the principles differentiate, or further differentiate, between different (i) resolution strategies (e.g., single point of entry vs. multiple point of entry); (ii) resolution entities (e.g., operating bank vs. holding company); or (iii) approaches to bail-in (e.g., open bank vs. closed bank bail-in)?

Owing to its global nature, the guidance developed by the FSB is general and indicative in its character. The points indicated in the question mostly concern issues which, if taken into account, would require regulations to be much more extensive and detailed, which would be incompatible with the universal character of the principles developed. It appears that where possible, the document takes these into account. It is worth noting, however, that the issue of excluding certain liabilities from being bailed-in may give rise to conflicts between resolution authorities from different countries. This may be of particular importance if the MPoE strategy is selected in which the home resolution authority will look for a universal rule while host country authorities may advocate another selection key which they believe is more appropriate for the country in question. On the other hand, the adoption of different exclusion rules (depending on the country) will not necessarily lead to a consensus, since it may give the impression that certain countries are privileged.

The Single Point of Entry (SPoE) strategy was already discussed by the Federal Deposit Insurance Corporation (FDIC) in connection with the Dodd-Frank regulation in the United States. In this case, the establishment of a bridge institution which could save a U.S. banking holding

in case of problems was considered. In the European practice, the application of the SPoE strategy appears to be less fair than the application of the Multiple Point of Entry (MPoE) one, in which loss-absorbing capacity is assigned to individual jurisdictions. There is a concern that losses within large groups will be assigned to local subsidiaries. For Poland, this is an important issue and it requires a broader discussion.

In general, it should be assumed that where individual entities within a SIB group are interrelated and integrated to a high degree (e.g. through centralised liquidity management or risk management), the application of the SPoE strategy is recommended. On the other hand, for SIB groups with a decentralised structure in which individual entities are self-sufficient in terms of their capital and liquidity, the application of the MPoE strategy would be reasonable. This choice of strategy depending on the degree of interrelation between entities within the SIB group would translate into management information, which would provide precise information required for the purposes of the bail-in process, including without limitation for the drawing up of reliable valuations, as quickly as possible.

Q 3. Do you agree with the information and disclosure requirements on the scope of bail-in as identified in principles three and four, respectively? Is the provision or disclosure of certain information likely to present any challenges for firms.

Proper communication with all stakeholders is a considerable challenge in the resolution process – the risk of panic is high and it may destabilise the entire sector, so a "reminder" of the need to pay special attention when planning and implementing communication strategies during the resolution process is valuable.

Disclosure of the data listed in Principles 3 and 4 is desirable from the supervisory point of view, since it reduces the information asymmetry between the supervised entity and the supervisor. This requirement will certainly increase the already high compliance costs at banking institutions.

Therefore, there is no doubt that supervisory authorities (including without limitation the institutions responsible for resolution) should have up-to-date data on the instruments that may be subject to bail-in, since this is a prerequisite for the efficient implementation of this procedure within a short time, which enables the entity in question to continue as a going concern. The data indicated in Principle 3 are easily available in the institution's systems, and thus their provision or disclosure should not be a problem (all the more so because most of this information is permanent, i.e. it is entered once for the instrument in question and does not change over time). I believe that it is possible to use the current data provision/supervisory report infrastructure for this purpose.

The disclosure of data to market participants also appears to be an indisputable requirement – it is the foundation of market discipline (private monitoring), which, as numerous empirical studies indicate, can be effective in the presence of institutional (formal) supervision. Additionally, research demonstrates that the effectiveness of market discipline is conditioned by, among other things, the issuance of subordinated debt by institutions. It can therefore be anticipated that the same will apply to the instruments subject to bail-in. An investor/client who assumes the risk will be more interested in monitoring the bank, and its investment decisions will be supported by thorough analyses. However, in order to be able to conduct such analyses, it must have data at its disposal. In this case, knowing the nature of the instrument (whether it is subject to bail-in) is of fundamental importance. It should additionally be noted that

supervisory activities should also support the development of market discipline (including the banks' transparency). In conclusion, (*ex ante*) disclosures, both to supervisory authorities and to the market, are an indispensable element of the resolution procedure. Banks have all the information whose disclosure is proposed here, and thus no additional costs will be generated. It is also possible to use existing reporting procedures and infrastructure.

It is worth adding that the minimum scope of information suggested in Principle 3 should also include data on the holder of the instruments issued by the bank (retail/institutional investor and institutional investor type, i.e. another bank, insurance company, non-financial company). However, access to this type of data may require cooperation with other institutions that operate the financial market infrastructure (e.g. securities depositories). For this reason, authorities should identify their needs with respect to access to specific data and ensure that an appropriate cooperation framework is established. At the same time, the requirement to provide information that is limited to the nature of the instrument holder (rather than the requirement to provide holder details) will be less burdensome and will not lead to conflicts, e.g. with personal data protection rules.

It should be stressed that the key challenge with respect to the information made available by institutions in terms of strategies and bail-inable instruments is to ensure that this is comparable between the various entities, including cross-border comparisons. For this reason, the instruments subject to bail-in or conversion should be presented in a uniform manner, which again may present a challenge given the differences between national regulations, e.g. tax regulations, which are important, for instance, from the point of view of determining the profitability of the instrument in question for the investor.

Q 4. Do you agree with the approach for valuations in resolution set out in principles five to eight, including with respect to (i) the valuation process and type of valuations that are necessary to inform a bail-in; and (ii) the methodology and assumptions for the valuations?

In principle, this is the right approach. However, certain doubts may be raised with respect to practical cooperation in this area between home and host authorities provided for in Principle 5 and the absence of a common preferred method for bank valuation during the resolution process.

A very important assumption is that safety-net institutions in the host country (which form the CMG) are able to influence valuation, and in particular its methodology. This is important both in the SPoE and MPoE strategies. Moreover, it is desirable that CMGs of all potentially involved countries be able to agree on a methodology. Differences between financial markets in different jurisdictions may be significant enough to justify differences in valuation methodology, but it is important that there is a consensus in this respect so that in no circumstances are the losses generated in one country transferred (or it is even suspected by market participants that they are transferred) to stakeholders from other countries.

As for the valuation methodology itself, establishing a separate international valuation standard to be used under resolution conditions should be considered. This would enable approaches to be harmonised and relevant knowledge and practice to be disseminated. This could be particularly useful if these procedures need to be implemented (the need to appoint valuers with adequate knowledge and experience).

It appears reasonable to take measures at the international level (at least at the level of the European Union or of the euro area) in order to make legal regulations uniform and strive

for standardisation in the processes and types of valuation used in bail-ins as well as in the methodologies and assumptions underlying valuation so that the valuation process is uniform irrespective of the country within this common area in which the parent entity and the subsidiary/subsidiaries within the framework of the SIB in question operate in order to ensure equal rights for creditors and shareholders in each of these countries, which will mitigate the risk that the resolution process is challenged by creditors and shareholders from those countries where the adopted valuation processes and types are less favourable to them than in other countries. The practical application of the transparency and *pari passu* principles invoked in Principles 5 to 8 is important for the credibility of the resolution process and increases the probability that corrective measures are successful.

Q 5. Does principle 10 identify all relevant challenges to the development of a bail-in exchange mechanic? What other challenges, if any, do you see?

It appears that Principle 10 identifies all major challenges. However, at this point two aspects should be pointed out that are not strictly related to bail-in but may affect its correct implementation.

First, when designing the bail-in exchange mechanic, an additional challenge may be the issue of existing court procedures in the countries involved in the bail-in, which concern challenging the resolution authority's actions (including valuations), and court powers to issue injunctions that secure the shareholders' and creditors' claims which are subject to bail-in and conversion, which injunctions could result in the decisions or actions of the resolution authority being halted. Therefore, it appears important to review the legal provisions in force in all jurisdictions subject to resolution that includes a bail-in procedure in order to verify whether the existing legal provisions allow for such a situation and whether regulations are already in force that prevent courts from halting and slowing down the resolution process. Resolution authorities should have the comfort of being able to operate in an effective and undisrupted manner, without any fear that a court which issues an injunction to secure the shareholders' and creditors' claims halts the decisions and actions of the resolution authority and thus prevents the crisis from being effectively remedied.

Second, local legal regulations related to special entities in which the Treasury holds a stake should additionally be taken into account as well as the restrictions related to legal requirements that protect the stake held by the Treasury, the prohibitions on bailing in and on the disposal of the shares held, and also special rules applicable to the management of state property.

Q 6. Do you agree with the approach to meeting securities law and disclosure requirements set out in principles 11 to 14? Are there other aspects of securities law or securities exchange requirements that should be considered by resolution authorities as part of resolution planning?

The approach presented is acceptable.

It is obvious that the applicable laws regarding disclosure of inside information by entities listed on the regulated market must be observed, including without limitation the provisions of Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC

of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC.

However, since resolution authorities are dealing with an area that is very important for the state's interests (the financial stability of the state) and the issues encountered are often global in their nature (SIBs use international holding structures) and thus their actions have an impact on the financial stability of the entire region or of several countries at the same time, these authorities should be afforded independence from these rules so that they can decide which information should be disclosed and which should not in order to avoid escalating the crisis at the bank in question and to ensure the effective achievement of resolution objectives. It should be noted that in such circumstances, resolution laws appear to have the status of special regulations (*lex specialis*) in relation to laws that govern the regulated market and as a result they have priority in the event of their incompatibility with the laws concerning the regulated market.

Since regulations on the disclosure of information usually provide for restrictions related e.g. to the risk of losing competitive position as a result of the information being disclosed or, more broadly, to detrimental effect on the undertaking's market situation, standards (good practices) should be developed that would indicate the types of information that do not violate these restrictions and thus there are no reasons not to disclose them (or, conversely, the types of information that should be disclosed irrespective of the circumstances).

Additionally, the importance of proper maintenance of an electronic register of financial instruments should be stressed. This register should contain all types of transferable assets, including without limitation unencumbered assets, which could be used as collateral to obtain liquidity from the central bank during the resolution process. The register must include all data required for identification purposes, including without limitation those concerning maturity dates so that the institution's current liquidity profile can be determined according to these maturities.

Q 7. Do principles 15 and 17 adequately describe the actions that the home resolution authorities should carry out regarding (i) the management and control of the firm during the bail-in period and (ii) the transfer of control to new owners and management?

- Principles 15 and 17 appear to adequately describe the responsibilities of resolution authorities. However, it should be stressed that these duties should be carried out by each resolution authority with respect to the banks under its jurisdiction (both as home and host authority), and not only by home authorities; similar obligations should be provided for the host authority with respect to group subsidiaries.
- Principle 15 describes the authorities' actions in a general manner, only touching upon the most important issues listed in the question, but given the volume of the draft guidance, this must necessarily be the case. A possible subject to consider could be the rules for concluding agreements, granting powers of attorney and generally outsourcing that should be applied both to the resolution administrator and to the entities that perform management activities with respect to the entity which is being bailed-in. Additionally, minimum eligibility requirements could be considered with respect to entities that are to serve as resolution administrators, management during the bail-in period or directors of the institutions subject to bail-in or of bridge institutions. Similarly, as in the case of entities which provide professional services related to the valuation of equity instruments

subject to bail-in or conversion, it appears that resolution authorities should also have a list of managers that includes specialised entities ready to act immediately upon the request of the resolution authority. Principle 16 perhaps touches upon this issue to a certain extent, but it is not articulated in such an unequivocal manner as above.

- As concerns Principle 17, it is worth pointing out that its description points to formal and legal issues related to the possible concentration of capital which may occur as a result of the bail-in, which results in legal consequences in terms of reporting such events to e.g. the competent competition watchdog and obtaining the relevant decisions. Hence, shareholders and other owners of a bailed-in entity should be able to obtain from the entity that manages the institution that is subject to bail-in, as quickly as possible and in a formally regulated manner, relevant information indicating the size of their shareholdings in the entire capital of the institution, group or holding, including without limitation information on the time limit and place for publishing the relevant notice. Among other things, the description of Principle 18 refers to these matters, suggesting that emphasis should be placed on the (expedited, if possible) issuance of regulatory approvals with regard to the consequences of exceeding the shareholding thresholds by creditors and shareholders of the bailed-in entity in order to ensure the effectiveness of corrective measures.
- From the banks' point of view, know-how and expertise concerning the specific characteristics of the institution in question may prove indispensable in the first stage of the resolution procedure. Therefore, in accordance with Principle 15, it is important to define clear management rules in the resolution process. In our opinion, a framework definition of the role of the bank's management board and managerial staff, i.e. the distinction between the old and new (for resolution purposes only) management teams during the bail-in procedure already at the stage of drawing up the resolution plan appears justified in order to guarantee efficiency and clear communication with stakeholders. The above may enhance the credibility of the resolution strategy so that the decisions made by the resolution authority or another authority indicated in the resolution plan are not only justified from the business perspective but also do not raise any doubts concerning their legality at a later date.

Q 8. Does principle 21 adequately identify all relevant types of information that the home resolution authority should communicate at the point of entry into resolution? What other information might creditors and/or market stakeholders require?

In our opinion, Principle 21 adequately identifies most relevant types of information that the resolution authority should communicate at the point of entry into resolution.

- We believe that the scope of information indicated should be extended to include practical guidelines for customers (especially the retail ones) concerning further steps that they must take after the authority has initiated the bail-in. Clear and simple information addressed at mass customers will prevent growing panic, which would adversely affect the effectiveness of the resolution process.
- This information should be provided by competent national authorities to customers of both parent companies and subsidiaries.

It should be stressed that communication at point of entry into resolution procedure should take place at the right time to avoid early market panic while ensuring that stakeholders have

access to relevant information in good time. In particular, a transparent and clear message should be sent to non-professional stakeholders, i.e. depositors who may be unduly concerned about the communication from the resolution authority despite the fact that their funds have been secured. This is particularly important due to the fact that the concept of resolution is still relatively new in the European legal environment and it remains vague for some financial market participants. In addition, the resolution authority should clearly communicate to the banks for which it has drawn up a resolution plan the division of competences related to providing notices of the considered or actual initiation of the resolution procedure. The overarching objective is to avoid a situation where, pursuant to applicable laws on communicating information, e.g. in the form of current reports, various parties would pre-empt one another's actions, causing confusion in the market.

In addition to the relevant categories of information listed in Principle 21, it appears that a separate item would be worth adding at the very end: information on how complaints should be lodged and how they will be handled as well as on further appeals against the decision of the resolution authority.

Such a list of relevant categories of information may also constitute an attempt at standardising communications, which would promote certainty and efficient operation, and this is very important for calming the situation and remedying initial panic given that crises at banks almost always result in destabilisation.

It is worth adding that creditors and, in general, bank stakeholders should be interested in the bank's current liquidity situation, e.g. Basel III daily liquidity indicators. Owing to the rapidly changing situation of a bank that is undergoing recovery/resolution procedures, an annual/quarterly or even monthly horizon may turn out to be insufficient. It should be realised that in the event of an emergency, high-quality liquid assets (HQLA) may drop significantly, and this may result in the inadequate funding of the resolution plan. Supervisory standards should be reported as frequently as possible, in particular with respect to HQLA.

Q 9. Are they any other actions that could be taken by firms or authorities to help facilitate the execution of a bail-in transaction and enhance market confidence?

It appears that two fundamental issues should be pointed out.

First, a significant increase in assets at the disposal of resolution funds, so that taxpayers are really convinced that it will not be them who will ultimately cover the costs of resolving systemically important banks, would be a systemic action that should enhance market confidence.

From the point of view of bail-in effectiveness, the draft guidance enclosed as Appendix 4 essentially addressed all relevant aspects of a bail-in transaction. It would be difficult to point out any other actions that were not touched upon, albeit briefly, in Appendix 4; one could possibly elaborate upon some issues that were only outlined, supplement descriptions of individual principles or further develop the 21 principles listed. Apart from the aforementioned issues, other actions aimed at facilitating the execution of a bail-in transaction and enhancing market confidence could be, e.g.:

1) the drawing up of official guidance, instructions, standards and minimum requirements by resolution authorities, preferably in a uniform manner in as many countries as possible, with respect to:

a) valuations, including valuers, valuation methodologies and minimum deadlines for individual activities, including the provision of specific information and requirements concerning IT and management infrastructure;

b) the standardisation of certain repetitive actions and basic scopes that form the core of all, or at least the majority of, bail-in transactions, including with respect to agreements with external companies and communications;

c) lists of entities that are ready to cooperate with resolution authorities and have the appropriate qualifications and experience;

2) communications to the market by banks and resolution authorities on the organisational measures taken in order to best prepare for a possible crisis in all respects, in order to convince the market that resolution is not a particularly negative phenomenon or a manifestation of a broader crisis, but rather a situation that is in fact normal and recurs periodically even in countries with robust economies and finances, and resolution authorities together with banks are prepared to implement ready-made recovery plans and have at their disposal a large number of renowned experts whose authority lends considerable credibility to the corrective measures taken and makes the positive ultimate effect of the resolution together with the bail-in mechanism much more probable;

3) parallel large-scale educational activities by the national resolution authorities together with a media information campaign, possibly implemented together with banking supervision authorities (considering that the Polish Financial Supervision Authority already has experience in undertaking such activities) – as *ex ante* measures.

Secondly, the banks subject to restructuring, after they have become profitable again, should pay contributions to a compensation fund from which those creditors who were bailed in would be satisfied, at least in part. This will improve the credibility of the banking system in the long term.