Commission Delegated Regulation (EU) 2016/860 of 4 February 2016 specifying further the circumstances where exclusion from the application of write-down or conversion powers is necessary under Article 44(3) of Directive 2014/59/EU of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms

COMMISSION DELEGATED REGULATION (EU) 2016/860

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THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012 of the European Parliament and of the Council[(1)], and, in particular, Article 44(11) thereof,

Whereas:

(1) In the context of resolution, it is essential that resolution authorities have sufficient guidance to ensure that the bail-in tool is applied properly and consistently across the Union. The principle that the bail-in tool may be applied to all liabilities unless they are explicitly excluded under Article 44(2) of Directive 2014/59/EU is overarching. For this reason, no liabilities should be presumed to be always excluded from bail-in unless they fall within the list of liabilities explicitly excluded under that provision. Indeed, already at the stage of resolution planning and resolvability assessment, the resolution authority should aim at minimising exclusions from bail-in with a view to respecting the principle that shareholders and creditor will absorb the costs of the resolution.

(2) A general principle governing resolution is that shareholders and creditors should absorb losses in resolution in accordance with the order of priority of their claims under normal insolvency proceedings. Furthermore, creditors of the same class should be treated in an equitable manner. Against this background, the discretion of resolution authorities to fully or partially exclude certain liabilities from bail-in and pass the losses onto other creditors or, where necessary, to the resolution funds needs to be clearly defined. Therefore, the circumstances allowing creditors to be excluded from bail-in need to be narrowly clarified and any deviation from the principle of equal treatment of creditors of the same rank (the so-called *pari passu* principle) must be proportionate, justified by the public interest and not discriminatory.

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(3) It is important to provide a framework for resolution authorities when exercising their power to exclude a liability or class of liabilities from bail-in, within the exceptional circumstances set out in Article 44(3) of Directive 2014/59/EU, in order to provide greater clarity to a given resolution scenario. However, a certain degree of flexibility is necessary for resolution authorities to assess whether exclusions are strictly necessary and proportionate on a case-by-case basis.

(4) The decision to use the bail-in tool (or other resolution tools) should be taken to achieve the resolution objectives in Article 31(2) of Directive 2014/59/EU. In the same vein, those resolution objectives should also inform the decisions regarding the use of the tool, including the decision to exclude a liability or class of liabilities from the application of bail-in in a given case.

(5) In line with these principles, the ability to exclude or partially exclude certain liabilities from the application of the write-down or conversion powers pursuant to Article 44(3) of the Directive 2014/59/EU should be limited to the minimum necessary to achieve the objectives which justify the exclusion. To this effect, wherever possible, the option to partially exclude a liability by limiting the extent of its write-down where this is sufficient to achieve the objective should be preferred to its complete exclusion from bail-in.

(6) The exceptional use of the power to exclude, fully or partially, a liability or class of liabilities should not affect resolution authorities' responsibilities to ensure that institutions and groups are resolvable, and that they hold sufficient funds to comply with the minimum requirement for own funds and eligible liabilities (MREL) in order to absorb losses in resolution and to ensure recapitalisation in accordance with the resolution plan. Indeed, pursuant Article 45(6)(c) of Directive 2014/59/EU, the relevant resolution authorities must take into account any likely exclusions when ensuring that an institution has sufficient loss absorption and recapitalisation capacity. In as much as the exclusion of certain liabilities from bail-in could substantially reduce the level of this capacity available in resolution, the likely need for such exclusions should be addressed by the resolution authority when setting MREL in accordance with Article 45(6)(c) of Directive 2014/59/EU.

(7) Given the exceptional character of the possibility for the resolution authority to exclude a liability or class of liabilities from bail-in under Article 44(3) of Directive 2014/59/EU, the resolution authority's assessment must be well founded. Where such exclusions would imply the use of the resolution fund, the resolution authority should provide a solid explanation on the exceptional circumstances leading to the exclusion. This explanation is essential for the Commission to be able to fulfil its mandate under Article 44(12) of Directive 2014/59/EU, pursuant to which the Commission must decide, within 24 hours of the notification by the resolution authority of the decision to exclude certain liabilities, whether it should prohibit or request amendment to the proposed exclusion. The explanation provided to the Commission by the resolution authority should be proportionate, and the need for expedience as warranted by the circumstances specific to the case should be taken into account.

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(8) In case of resolution, liabilities counted towards the MREL should, in principle, always be bailed in to the extent necessary to absorb the losses and recapitalise the institution, in as much as resolution authorities at the time of the resolution planning indeed foresee that those liabilities contribute in a credible and feasible manner to loss absorption and recapitalisation. In the exceptional cases where the resolution authority needs to make use of an exclusion under Article 44(3) of Directive 2014/59/EU which has not been considered in the resolution planning, and where such exclusions would imply the use of the resolution fund, the resolution authority should explain which exceptional circumstances justify the exclusion, and the reasons why those exceptional circumstances could not have been foreseen by the resolution authority at the moment of resolution planning. The requirement to explain these factors should be applied proportionately and appropriately with respect to the need for timely resolution action.

(9) The ability to exclude liabilities from bail-in under Article 44(3) of Directive 2014/59/EU should be exercised in full respect of the general principles of the Union law and, in particular, should not affect the safeguards protecting other creditors, namely the principle that no creditor should bear greater losses than he would have incurred had the institution been wound-up under normal insolvency procedures (‘no creditor worse off’ (NCWO) principle). Resolution authorities should be mindful of the need to respect these safeguards and the risk of compensation of creditors associated with the breach of these safeguards when making exclusions under Article 44(3) of Directive 2014/59/EU, and when preparing the resolution plan. However, the fact that courts may review the resolution authority's decision to exclude a liability should not be the sole ground for further exclusion. This should be without prejudice to due consideration being given to previous court decisions relating to resolution actions where they are relevant for the specific case.

(10) The overall capacity of the resolution authority to make exclusions is limited by the fact that losses which are not fully absorbed by creditors due to exclusions may be covered by the resolution financing arrangement only when shareholders and creditors have contributed an amount equal to at least 8 % of the institution's total liabilities, including own funds.

(11) Exclusions should be considered on a case-by-case basis by analysing relevant considerations under each of the potential reasons for exclusion under Article 44(3) of Directive 2014/59/EU, rather than by considering the specific nature of the institutions concerned in isolation. This approach should ensure consistent consideration of exceptional circumstances and avoid unnecessary competitive distortions. The characteristics of an institution (such as size, interconnectedness or complexity) should be taken into account, where relevant, in order to assess whether the circumstances justifying exclusion of a liability from bail-in are met. However, those characteristics should not automatically justify exemptions of such an institution's liabilities from bail-in.

(12) Some general factors, such as market conditions, circumstances of failure or the level of losses incurred by the institution, might affect the likelihood that exceptional circumstances, as defined in Article 44(3) of Directive 2014/59/EU, will arise. However

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such general factors should not constitute further independent grounds for exclusion beyond those listed under Article 44(3)(a) to (d) of Directive 2014/59/EU.

(13) When considering whether one or more of the circumstances justifying exclusions from bail-in are met, the resolution authority should consider the amount of time after which the imminent failure of an institution could no longer be handled in an orderly manner. Where resolution plans and MREL for each institution have been defined and impediments to resolution have been addressed, it is expected that the institution should have the necessary capacity to absorb the losses and be recapitalised. Indeed, the resolution scheme should follow the resolution plan, including the resolution strategy, unless taking into account the circumstances of the case the resolution authority assesses that the resolution objectives will be achieved more effectively by taking actions not provided for in the resolution plan.

(14) During the period when resolution plans and MREL have not yet been adopted, and where there has been limited time available for deciding on the detailed implementation of the resolution strategy by the resolution authority, it is more likely that there will be instances where it is not possible to apply the bail-in tool to all eligible liabilities within a reasonable time. The determination of what constitutes 'a reasonable time' should be connected to the speed and certainty required to finalise the bail-in by a certain date to effectively stabilise the firm. Where it is not feasible to perform all the tasks needed to bail-in certain liabilities by that date, it should be considered not possible to bail-in 'within a reasonable time'. The decision as to when 'difficult' amounts to 'impossible' should be made based on the criteria defining a 'reasonable time'.

(15) In principle, liabilities governed by the law of a third country are bail-inable to the extent that they are not excluded under Article 44(2). The mechanism provided for under Article 55 aims to increase the likelihood that those liabilities can be bailed within a reasonable time. As importantly, Article 67 of the Directive 2014/59/EU provides discretion for resolution authorities to require that the administrator, receiver or any other person exercising control of the institution under resolution take all the necessary steps to ensure that write down or conversion of liabilities governed by the law of a third country becomes effective. However, in view of the fact that such liabilities are not governed by EU law, a residual risk remains that in exceptional cases in spite of best efforts on behalf of the resolution authority, including exercise of discretion under Article 67, problems with bail-inability of such liabilities within a reasonable time are encountered.

(16) A practical obstacle to the bail-in of certain liabilities may include the fact that the amount of the liability is not determined or is difficult to determine at the point in time when the resolution authority applies the bail-in tool. This may be the case for secured liabilities exceeding the value of the relevant collateral, or liabilities which are contingent on uncertain events in the future, such as off-balance-sheet items or undrawn commitments. Such obstacles may be overcome through appropriate valuation, such as cancelling the liability and determining the value by estimation, using a relevant valuation methodology, or applying a 'virtual' percentage haircut ratio.

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(17) While it is true that in some instances derivatives may also prove difficult to bail-in, Article 49 of Directive 2014/59/EU clearly stipulates how derivatives should be bailed-in, namely following a close-out. The fact that it may be difficult to determine the netted amount following the close-out within a short time should not entail an automatic exclusion since this may also be addressed through relevant valuation methodologies as laid down by the Commission under Article 49(5) of Directive 2014/59/EU, especially at the stage of the provisional valuation. In this vein, institutions should be required to demonstrate that they are capable of providing the information necessary to carry out a valuation for the purpose of resolution. In particular, resolution authorities should ensure that institutions are in a position to produce the required up-to-date information within the time frame under the resolution strategy, in particular to support a credible valuation before and during resolution under Article 36 of Directive 2014/59/EU. In addition, the guidelines stipulate that resolution authorities should consider requiring institutions to divest assets which significantly impair the feasibility of the valuation.

(18) Article 2 of Directive 2014/59/EU defines the notion of critical functions and core business lines. The Commission is empowered to adopt a delegated act to further specify the circumstances under which certain activities, services and operations could fall under the definition of critical function or core business line. In this respect, the profitability of a business line is not in itself a sufficient reason for exclusion from bail-in of liabilities related to that business line. Exclusion may be justified, however, where maintaining a core business line is critical for achieving the resolution objectives, including maintaining critical functions, where these are furthered by the continuation of key operations, services and transactions.

(19) Resolution authorities may only exclude liabilities which are required for risk management (hedging) purposes in the context of critical functions, if the risk management (hedging) is recognised for prudential purposes and is essential for maintaining operations related to critical functions, so that if the hedge were unwound, the continuity of the critical function would be seriously jeopardised.

(20) Also, resolution authorities may only exclude liabilities which are required for risk management (hedging) purposes in the context of critical functions if, were the risk management measure unwound, it would be impossible for the institution to replace it on reasonable terms within the time required for maintaining the critical function for instance due to spreads or uncertainty in valuation.

(21) Preventing contagion to avoid a significant adverse effect on the financial system is a further resolution objective which may justify an exclusion from the application of the bail-in tool. In any event, exclusion on this basis should only take place where it is strictly necessary and proportionate, but also where the contagion is so severe that it would be widespread and severely disrupt the functioning of financial markets in a manner that could cause a serious disturbance to the economy of a Member State or of the Union.

(22) A certain risk of some contagion may be inherent to the application of the bail-in tool. The legislative decision to enshrine the bail-in tool in Directive 2014/59/EU as a key resolution tool, together with the principle that creditors and shareholders should