

Information on bank resolution under the Austrian Act on Bank Recovery and Resolution.

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The Austrian Act on Bank Recovery and Resolution (“BaSAG”) includes rules for the resolution of banks, transposing an EU Directive into national law.

What does bank resolution mean?

The resolution of banks is a procedure carried out by a public authority to react quickly to financial distress at a bank (i.e. a bank considered to be failing or likely to fail). In contrast to bankruptcy proceedings, the focus is not on maximising assets from the sale of the bank, but rather on quickly stabilising the bank’s core functions by applying resolution tools. The use of taxpayers’ money and contagion in financial markets are to be avoided.

Decisions to initiate a resolution procedure and apply resolution tools are made by the resolution authority. The Single Resolution Board of the European Union is the resolution authority for systemically important banks in the euro area, including UniCredit and Bank Austria. And there are resolution authorities in the various countries for banks in the euro area which are not systemically important (in Austria, the Financial Market Authority is the resolution authority) on the basis of applicable law.

How can bank customers be affected by bank resolution?

The competent resolution authority may apply resolution tools to a bank only if the legal requirements are met. Bank customers may be affected by the application of the following resolution tools:

- sale of business tool,
- bridge institution tool,
- asset separation tool,
- bail-in tool.

The sale of business tool

The resolution authority can use this tool to transfer liabilities and/or assets of the bank under resolution to a purchaser that is not a bridge institution.

Bank customers may be affected by such a transfer in the form of a new business partner as the purchaser of the bank which is in financial distress takes over the assets (loans granted to customers) and liabilities (debt securities issued by the bank, e.g. bonds).

The bridge institution tool

In this case the liabilities and/or assets of the bank under resolution are transferred to a company (“bridge institution”) of the Republic of Austria or of another public sector entity. The bridge institution ensures that critical functions of the bank (activities and services of the bank whose discontinuation may have a negative impact on the real economy or on financial market stability) can be maintained (“good bank”). Bank customers have a new business partner in this case, too.

The asset separation tool

The resolution authority may issue an order to transfer assets and/or liabilities of the bank under resolution to one or several special purpose entities (resolution entities) with the objective of reducing the portfolio (“bad bank”).

In the context of the sale of business tool, the bridge institution tool and the asset separation tool, bank customers are exposed to the risk that the respective purchaser cannot meet its obligations (such as obligations to pay interest and/or repay principal).

The bail-in tool

The most important resolution tool defined in the BaSAG is the bail-in tool. This tool ensures that losses, and the costs of stabilisation, of the bank under resolution must first be borne by the owners of a bank (e.g. shareholders) and by unsecured creditors rather than by the state and taxpayers. A bail-in involves the proportionate reduction or full write-off of existing ownership interests of shareholders in the bank; creditors must waive their claims in full or in part and may receive ownership interests in the bank in some cases. This conversion of debt into equity serves to recapitalise the bank.

The bail-in concept covers various creditor groups. While some creditors are fully excluded from bail-in, others have to absorb losses in an exactly defined sequence (“loss-absorption cascade” or “liability cascade”). Losses are absorbed on a tier basis, i.e. creditors of the next higher tier are only bailed in if the claims of the preceding tier of creditors are not sufficient to cover the losses.

Sequence of allocation of losses:

1st tier:

The owners of Tier 1 capital (e.g. shareholders) of the banks concerned bear the highest risk of loss.

2nd tier:

Subsequently, where necessary, bail-in is applied to those investors who have invested in Additional Tier 1 capital instruments (e.g. Additional Tier 1 capital issues).

3rd tier:

Here, the resolution authority has recourse to creditors who have invested in Tier 2 capital instruments (e.g. Tier 2 capital issues, participation rights).

4th tier:

The bail-in tool is applied to unsecured and subordinated financial instruments and claims (e.g. subordinated debt instruments) which do not meet the criteria for Additional Tier 1 capital or Tier 2 capital.

5th tier:

To cover any losses, the bail-in tool is applied in this category to senior non-preferred debt instruments (e.g. Senior non-preferred bonds) which meet specific legal requirements. These debt instruments must have an original contractual maturity of at least one year, they may not contain embedded derivatives and may not be derivatives themselves. In addition, the contractual documentation and, where applicable, the prospectus relating to the issuance explicitly refer to the lower ranking in the insolvency proceedings.

6th tier:

The owners of other unsecured and non-subordinated debt instruments and claims are required to cover losses at this stage where necessary (e.g. investors who have invested in bearer bonds, structured bonds (such as index certificates), derivatives, and uncovered deposits from large companies in excess of EUR 100,000).

7th tier:

Uncovered deposits (i.e. deposits not covered by the deposit guarantee scheme) in excess of EUR 100,000 from private individuals and from small and medium-sized businesses enjoy a privileged status, being the last category to which the bail-in instrument is applied, if at all ("preferred deposits").

The examples listed in the sequence of allocation of losses are provided for a better understanding; the actual allocation of losses to a specific tier ultimately always depends on the case-by-case nature of the products involved.

In individual cases, apart from exceptions defined by law, the resolution authority may fully or partly exclude from bail-in specific liabilities of the bank which are subject to bail-in pursuant to the BaSAG. Under a bail-in procedure, no creditor may be worse off than under ordinary insolvency proceedings.

The application of the bail-in instrument may lead to the partial, or even total, loss of the capital invested by the investor.

What claims of bank customers are excluded from bail-in?

There is no bail-in risk, for example, in relation to:

- Covered deposits from bank customers (deposits covered by the deposit guarantee scheme up to EUR 100,000 per depositor and bank).
- Secured claims, such as investments in mortgage bonds or covered bonds.
- Liabilities arising from trustee operations.
- Customer assets and funds to which segregation or other special rights apply (no bail-in risk for the custodian bank in respect of investment fund assets).

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What risks may a bank resolution involve for bank customers?

• Counterparty/credit risk:

The resolution authority may change the basic terms and conditions of the securities concerned, e.g. by changing the maturity date or deferring interest payments for a certain period.

• Liquidity risk:

Securities prices are sensitive to market fluctuations, especially securities issued by a bank for which a bail-in procedure was initiated. This means that investors are exposed to a risk that the securities concerned, or other securities issued by the bank concerned, cannot be sold or can only be sold at a lower price.

• Concentration risk:

The risk of loss increases the more securities of the bank under resolution are included in the investor's portfolio (up to the risk of total loss of the amount invested).

Are bank customers exposed to the risk of resolution and bail-in risk only in relation to Austrian banks?

No. All credit institutions in the European Union (EU) which accept deposits or other repayable funds from customers and extend loans on their own account are subject to the EU Directive on the recovery and resolution of credit institutions. EU member states are required to transpose this EU Directive into national law. In Austria, the EU Directive was transposed into Austrian law with the Federal Act on Bank Recovery and Resolution.

Moreover, international organisations have issued global guidelines for the resolution of systemically important banks which also apply to banks outside the EU.

Have there been any changes to deposit guarantee schemes as a result of the bank resolution and bail-in legislation?

The coming into force of the BaSAG has had no effect on the key provisions of the Austrian Banking Act (BWG) as far as the deposit guarantee is concerned. As in the past, deposits on accounts and/or savings accounts are covered by the deposit guarantee scheme up to a total amount of EUR 100,000 per customer and bank (covered deposits). If a customer's access to his/her covered deposits is not hindered by the application of a resolution tool (e.g. transfer of the deposits to a bridge institution), there are no grounds for a claim to compensation from the deposit guarantee scheme.

Further information on bank resolution

Austria's central bank (Oesterreichische Nationalbank – OeNB):
<https://www.oenb.at/en/financial-market/three-pillars-banking-union/single-resolution-mechanism.html>

Austrian Financial Market Authority (Österreichische Finanzmarktaufsicht – FMA):
<https://www.fma.gv.at/en/bank-resolution/>