



**Operationalisation of the write-down and conversion and
the bail-in tool**

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I Background

The Croatian National Bank (CNB), in its capacity as the national resolution authority (NRA) for credit institutions (banks) in the Republic of Croatia, publishes this document containing a description of its approach to the execution of the write-down and conversion and the bail-in tool when dealing with failing banks, thereby bringing into compliance its actions with the *Guidelines to resolution authorities on the publication of the write-down and conversion and bail-in exchange mechanic*¹ of the European Banking Authority.

II Introduction

On 15 May 2014, the *Bank Recovery and Resolution Directive*² (BRRD) was adopted by the European Parliament and the Council in order to provide NRAs with comprehensive and effective powers for dealing with failing banks and in-scope investment firms. The BRRD is transposed into Croatian law via the *Act on the Resolution of Credit Institutions and Investment Firms*³ (Resolution Act). According to the Resolution Act, the CNB is the NRA for banks in the Republic of Croatia, and the write-down and conversion and the bail-in tool are powers, among others, that the CNB has at its disposal to intervene in a bank that is failing or likely to fail (FOLTF).

On 30 July 2014, the *Single Resolution Mechanism Regulation*⁴ (SRMR) was adopted. It established a banking union⁵ level resolution entity, the Single Resolution Board (SRB), with centralized resolution powers and responsibilities. The SRMR applies on the territory of the Republic of Croatia from 1 October 2020 when the *Decision on the establishment of close cooperation between the European Central Bank (ECB) and the CNB*⁶ took effect.

The effect of the SRMR was to move most of the resolution powers and responsibilities under the BRRD from the national level to the SRB with regard to (i) significant banks (SIs) that are directly supervised by the ECB and (ii) less significant banks (LSIs) that are part of cross-border groups which have entities in two or more countries which are part of the banking union and whose parent entity has its registered office in a country which is a part of the banking union (cross-border groups), although the NRA is responsible for implementing the decisions of the SRB. For the write-down and conversion and the bail-in tool, this means that for SIs and cross-border groups the SRB decides on their application through a so-called resolution scheme, and that the NRA implements the SRB's resolution scheme by adopting its

¹ Guidelines to resolution authorities on the publication of the write-down and conversion and bail-in exchange mechanic (EBA/GL/2023/01).

² 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 (OJ L 173, 12.6.2014).

³ Act on the Resolution of Credit Institutions and Investment Firms (Official Gazette 146/2020, 21/2022).

⁴ Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010 (OJ L 225, 30.7.2014).

⁵ All euro area Member States are part of the banking union, Croatia and Bulgaria being the latest countries to join on 1 October 2020. Non-euro area European Union Member States can join the banking union by entering into close cooperation with the European Central Bank.

⁶ Decision (EU) 2020/1016 of the European Central Bank of 24 June 2020 on the establishment of close cooperation between the European Central Bank and Hrvatska narodna banka (ECB/2020/31, OJ L 224I, 13.7.2020).

national implementing decision. On the other hand, for the remaining banks, meaning LSIs that are not part of cross-border groups, the NRA independently adopts the decision on the application of the write-down and conversion and the bail-in tool.

III General aspects of the write-down and conversion and the bail-in tool

The goal of the write-down and conversion and the bail-in tool is to ensure that the losses and costs of the failing bank are borne primarily by its shareholders and creditors, the insiders, and as such they represent the complete opposite of the former so-called bail-out, which implied placing the burden of resolving the bank on the outsiders, such as taxpayers. In other words, by applying the write-down and conversion and the bail-in tool, in contrast to the former bail-out, the losses and costs of a bank are absorbed from within in such a way that shareholders and creditors bear the losses first.

The bail-in tool is one of the resolution tools⁷ that the NRA can apply in respect of a bank that meets the following conditions for resolution:

- a) the bank is FOLTF;
- b) it is not reasonable to expect that any alternative measures would prevent the failure of the bank within a reasonable timeframe; and
- c) the resolution is in the public interest. This involves assessing whether resolution is necessary for the achievement of and is proportionate to one or more of the resolution objectives and whether normal insolvency proceedings⁸ would meet those resolution objectives to the same extent. The resolution objectives are:
 - a) ensuring the continuity of critical functions;
 - b) avoiding a significant adverse effect on financial stability;
 - c) protecting public funds by minimising reliance on extraordinary public financial support;
 - d) protecting covered depositors and investors; and
 - e) protecting client funds and assets.

A distinction must be made between the write-down and conversion and the bail-in tool. Write-down and conversion is not, strictly speaking, a resolution tool, but it is one of the measures available to the NRA. Write-down and conversion may be applied to banks both in and out of resolution.

Application out of resolution may occur if the competent authority considers that the bank is no longer viable without the write-down and conversion. The write-down and conversion out of resolution involves a decrease/write-down of, including to nil:

- a) retained profit;
- b) reserves;
- c) the value of shares and other Common Equity Tier 1 instruments;

⁷ Under the Resolution Act, there are in total four resolution tools that the CNB as the NRA can apply in respect of a bank that meets the conditions for resolution: the sale of business tool, the bridge institution tool, the asset separation tool and the bail-in tool.

⁸ In the Republic of Croatia, compulsory liquidation of banks, as regulated by the Act on Compulsory Liquidation of Credit Institutions (Official Gazette 146/2020), is considered to be normal insolvency proceedings within the meaning of the Resolution Act.

- d) the principal amount of Additional Tier 1 capital;
- e) the principal amount of Tier 2 capital; and
- f) the principal amount of claims of parent undertakings as owners of instruments used by subsidiaries to meet the minimum requirement for own funds and eligible liabilities on an individual basis (**internal MREL**),

and/or, ultimately, the conversion, full or partial, of Additional Tier 1 capital, Tier 2 capital and internal MREL into shares.

If it has been established that the conditions for resolution have been met, the bank will be placed in resolution and the bail-in tool will be applied sequentially after the write-down and conversion to bailinable liabilities⁹, starting with the subordinated debt that is not Additional Tier 1 or Tier 2 capital, respecting the reverse hierarchy of creditors in normal insolvency proceedings. The write-down and conversion in resolution involves a decrease/write-down of, including to nil:

- a) retained profit;
- b) reserves;
- c) the value of shares and other Common Equity Tier 1 instruments;
- d) the principal amount of Additional Tier 1 capital;
- e) the principal amount of Tier 2 capital; and
- f) the principal amount of internal MREL (if the write-down and conversion out of resolution was not applied)

and/or, ultimately, the conversion, full or partial, of Additional Tier 1 capital, Tier 2 capital and internal MREL into shares (the latter only if the write-down and conversion out of resolution was not applied).

After the execution of the write-down and conversion, the bail-in tool involves the decrease/write-down, including to nil, of subordinated debt that is not Additional Tier 1 or Tier 2 capital and other bailinable liabilities, and/or, ultimately, the conversion, full or partial, of subordinated debt that is not Additional Tier 1 or Tier 2 capital and other bailinable liabilities.

IV Operationalisation of the write-down and conversion and the bail-in tool

This chapter illustrates the operationalisation of the write-down and conversion and the bail-in tool in resolution through a simplified and hypothetical example of a failing less significant bank in the Republic of Croatia, which is not part of a group and which is directly supervised by the CNB as the competent authority as well¹⁰.

It should be noted that the timelines are merely indicative and that there may be a certain degree of overlap between steps.

⁹ Bailinable liabilities means the liabilities and capital instruments which do not qualify as Common Equity Tier 1, Additional Tier 1 or Tier 2 capital of a bank and that are not excluded from the scope of the bail-in tool pursuant to Article 80 paragraph 2 of the Resolution Act.

¹⁰ In the Republic of Croatia, the ECB directly supervises SIs and the CNB LSIs.

1. Preparation for resolution

1.1 Obtaining a valuation of the bank	T-x	<p>The CNB as the resolution authority instructs an independent valuer to prepare a valuation to inform the decision on the appropriate resolution actions if the conditions for resolution are met. The determination of whether the conditions for resolution or the conditions for the write down and conversion are met shall also be included in the valuation.</p> <p>If a complete valuation is not possible, a provisional valuation would initially be sufficient. Also, where an independent valuation is not possible, the CNB as the resolution authority may carry out a provisional valuation. However, a final independent valuation should then be prepared at a later stage.</p>
1.2 Assessing the three conditions for resolution	T-x	<p>The CNB as the competent authority assesses FOLTF, while the CNB as the resolution authority assesses the remaining two conditions for resolution (alternative measures and public interest). The CNB as the competent authority consults the CNB as the resolution authority when determining FOLTF. The CNB as the resolution authority determines that the conditions for resolution have been met.</p>
1.3 Assessing the preferred resolution strategy and tool(s)	T-x	<p>The CNB as the resolution authority, taking into account the valuation from step 1.1, assesses the preferred resolution strategy and tool(s) and decides to apply the write-down and conversion and the bail-in tool.</p>

Duration: (1 day - 3 months)

2. Resolution weekend

If the situation allows, the final preparations of the resolution actions take place over a weekend. The weekend is often called the “resolution weekend”. Depending on the circumstances, the decisions and actions described in this section may need to be taken at a time other than during a weekend.

2.1 Adoption of the FOLTF Decision	T-x	The CNB Council adopts the FOLTF Decision.
2.2 Submission of the draft Decision on the opening of	T-x	The CNB as the resolution authority submits the draft Decision on the opening of resolution proceedings (Resolution Decision) to the SRB for assessment.

resolution proceedings to the SRB for assessment		
2.3 Obtaining all necessary approvals/consents	T-x	<p>If the application of the write-down and conversion and the bail-in tool results in the acquisition of or increase in a qualifying holding in the bank, the acquirer of a qualifying holding must obtain the consent by the CNB as the competent authority.</p> <p>Provided that the Resolution Decision has a direct fiscal impact or systemic implications, the Ministry of Finance of the Republic of Croatia needs to formally approve the contents of the planned measures before the adoption of the Resolution Decision.</p>
2.4 Adoption of the Resolution Decision	T	<p>The CNB Council adopts the Resolution Decision.</p> <p><u>Write down and conversion</u>¹¹</p> <p>Depending on the amount of bank's losses, the Resolution Decision provides for the decrease/write-down of, including to nil:</p> <ul style="list-style-type: none"> - retained profit; - reserves; - the value of shares and other Common Equity Tier 1 instruments; - the principal amount of Additional Tier 1 capital; - the principal amount of Tier 2 capital; <p>and/or conversion, full or partial, of Additional Tier 1 capital and Tier 2 capital, which is carried out by increasing the share capital through issuance of new shares.</p> <p><u>Bail-in tool</u></p> <p>The Resolution Decision provides for the decrease/write-down, including to nil, of subordinated debt that is not Additional Tier 1 or Tier 2 capital and other bailinable liabilities, and/or, ultimately, the conversion, full or partial, of subordinated debt that is not Additional Tier 1 or Tier 2 capital and other bailinable liabilities, which is carried out by increasing the share capital through issuance of new shares.</p>

¹¹ Since the hypothetical example involves a bank that is not part of a group, there is no internal MREL that could be affected by the write down and conversion.

		At this moment the CNB as the resolution authority shall not resort to the issuance of interim instruments.
2.5 Adoption of the Decision on the appointment of the resolution administration	T	Simultaneously with the adoption of the Resolution Decision, CNB Governor adopts the Decision on the appointment of the resolution administration which will take control over the bank.

Duration: (1 day - 1 month)

3. Implementation of the resolution decision

3.1 Publishing the Resolution Decision and the Decision on the appointment of the resolution administration	T	Before markets open after the resolution weekend, the CNB as the resolution authority publishes the Resolution Decision and the Decision on the appointment of the resolution administration on its website.
3.2 Notifying stakeholders	T	<p>The CNB as the resolution authority notifies the following stakeholders on the adoption of the Resolution Decision and the Decision on the appointment of the resolution administration:</p> <ul style="list-style-type: none"> - the bank concerned; - the Ministry of Finance; - the Croatian Deposit Insurance Agency; - the competent authorities for each branch of the bank in other Member States, where applicable; - the Financial Stability Council and the European Systemic Risk Board; - the European Banking Authority; - the European Commission; - the European Central Bank; - the European Securities and Markets Authority; - the European Insurance and Occupational Pensions Authority; and - the operators of the systems in which the bank participates, where applicable.

<p>3.3 Taking control of the bank under resolution</p>	<p>T+x</p>	<p>The Resolution Decision provides that the CNB as the resolution authority has the rights and powers previously exercised by the Supervisory Board and the bank's shareholders. The legal effects of the transfer of powers enter into force on the date of the opening of the resolution proceedings.</p> <p>The resolution administration appointed by the Decision on the appointment of the resolution administration takes over control of the bank instead of its previous Management Board. The legal effects of the appointment of a resolution administration enter into force on the date of the opening of the resolution proceedings, while all powers of former members of the management board of the bank cease.</p>
<p>3.4 Suspension/exclusion from trading/withdrawal from the exchange</p>	<p>T+x</p>	<p>In the event of failure of a bank whose instruments are admitted to trading on a regulated market, the CNB as the resolution authority will inform the relevant regulated market operator without delay. In the Republic of Croatia this is the Zagreb Stock Exchange¹².</p> <p>At the request of the CNB as the resolution authority, the relevant regulated market operator makes use of its authority to suspend shares and/or debt instruments or exclude them from trading. Once the CNB, as the resolution authority, assumes the rights of shareholders, it may also decide to withdraw the shares and/or debt instruments from the exchange. The CNB as the resolution authority and/or the relevant regulated market operator will consider exercising these powers if it is necessary to implement a specific change in connection with the financial instrument(s) or if this is required in view of the protection of investors or the orderly trade of the financial instrument(s).</p> <p>In order to enable the settlement of unsettled transactions in relation to instruments that were traded before the Resolution Decision, these are so-called "in-flight transactions", the transferability of the instruments concerned will not be limited in any way.</p>
<p>3.5 Implementing the write-down and conversion and the bail-in tool</p>	<p>T+x</p>	<p>Relevant stakeholders ensure that all the necessary actions are taken to implement the write-down and conversion and the bail-in tool.</p>

¹² <https://zse.hr/en>

		In order to enable the settlement of transactions that were not settled before the opening of resolution proceedings, the so-called “in-flight transactions”, the transferability of the instruments concerned registered with the Central Depository & Clearing Company Inc. ¹³ , as the central securities depository (CSD) in the Republic of Croatia, will not be limited in any way.
3.5.1	T+x	The competent commercial court registry (depending on the registered office of the bank) shall register the decision on the decrease and increase of share capital in the court registry.
3.5.2	T+x	As a general rule, the Resolution Decision sets out the instruments to be written down by the bank in resolution and/or CSDs and the amount of such write-down. The bank in resolution and/or the CSDs perform the write-down and notify directly registered holders that the write-down has been performed. As a general rule, the instruments whose values have been decreased/written down to nil shall be withdrawn.
3.5.3	T+x	Concurrently with the write-down as described in the previous step, the CNB as the resolution authority requires the bank in resolution and/or the CSDs to issue new shares to be held on a custody account. If only a provisional valuation is available, new shares shall be held on a custody account on behalf of the bailed-in creditors until completion of final valuation. This ensures a correct allocation of shares based on the final valuation result and reduces the risk of an unintended transfer. If the technical conversion ratio contains fractional amounts, the so-called “fractional shares”, these are rounded down by the CSD. If the need for write-down and conversion according to the final valuation is less than the need according to the provisional valuation, the CNB as the resolution authority shall increase the value of the claims of creditors or holders of relevant capital instruments.
3.6 Launching “no creditor worse off” assessment	T+x	Once all the resolution actions have been taken, a valuation is performed to assess whether the bank’s shareholders, creditors or the deposit guarantee scheme would have been

¹³ <https://www.skdd.hr>

		better off if the bank had instead been managed through normal insolvency proceedings. If the valuation shows that they would have been better off, they would be entitled to compensation for the difference.
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Duration: (1 day - 3 months)

4. Closing of the resolution

4.1 Adoption of the Decision on the completion of resolution proceedings	T+x	After the grounds for opening resolution proceedings have ceased to exist or after all the necessary resolution actions have been taken, the CNB Council shall adopt the Decision on the completion of resolution proceedings.
4.2 Results of "no creditor worse off" assessment	T+x	Bank's shareholders, creditors or the deposit guarantee scheme are compensated if they incurred greater losses in resolution than they would have incurred under normal insolvency proceedings.

Duration: (3–6 months)

From step 2.4 onwards, the flowchart is also applicable to banks under the SRB's direct responsibility. The CNB Council shall adopt the Resolution Decision in accordance with the SRB's resolution scheme, while the "no creditor worse off" assessment, mentioned for the first time in step 3.6, is to be carried out by the SRB and not the CNB. Also, if a bank under the SRB's direct responsibility is part of a group, the internal MREL might also be affected by the write-down and conversion, which is not the case with a less significant bank which is not part of a group as in the above-described example.

V Conclusion

If the resolution objectives or the circumstances of the case so require, the CNB may choose to apply the write-down and conversion and the bail-in tool differently than set out in this paper. Also, this paper only concerns the execution of the write-down and conversion and the bail-in tool under the BRRD as transposed into the Resolution Act and the SRMR.

This paper is a living document, susceptible to updates and shall be updated where the approach of the CNB to the execution of the write-down and conversion and the bail-in tool changes.