The Czech National Bank's approach to the implementation of bail-in

In a previously published explanatory memorandum (pdf, 91 kB), the CNB indicated that in the case of complex and systemically important institutions or their groups, it considers bail-in to be the primary resolution tool for addressing their potential failure. With regard to the structure of the Czech banking sector, bail-in is thus the preferred or variant resolution tool for institutions managing the absolute majority of banking assets in the Czech Republic.

Using bail-in as such consists in the write-down and conversion of capital and liabilities that are not compulsorily excluded under Article 122 of the Act No. 374/2015 Coll., on Recovery and Resolution in the Financial Market (RRA), to the extent sufficient to restore regulatory capital to the level necessary for continuation of the activities for which the institution is authorised (in particular identified critical functions) and to maintain sufficient market confidence. Bail-in as such is implementable on the basis of a decision issued by the CNB, in its role as a resolution authority, and must respect the order in which creditors from the instruments concerned would be satisfied in insolvency proceedings (see the order of claims in domestic insolvency proceedings).

If resolution proceedings using bail-in are to achieve their objectives as set out in Article 75 of the RRA, the tool must be implemented in a credible and transparent manner. This requires both sufficient preparation on the part of active participants in the process (i.e. the failing institution, the CNB, persons maintaining central securities depositories or other persons keeping records of instruments concerned, organisers of regulated markets, etc.) and the ability of market participants to anticipate each step taken throughout the resolution process.

To enhance the transparency and predictability of actions to apply bail-in, and in accordance with the requirements of EBA/GL/2023/01, the CNB is hereby publishing its approach to the bail-in execution process. When preparing this approach, the CNB mainly relied on the applicable legal framework and the *Principles on Bail-in Execution*[1] issued by the Financial Stability Board, and worked in a close cooperation with the Central Securities Depository Prague, the Prague Stock Exchange and the CNB's departments supervising and overseeing these financial market infrastructures ("FMIs"). The proposed approach uses the existing procedures, technologies and conventions of the above-mentioned FMIs as much as possible and takes into account the possible involvement of international central securities depositories ("ICSDs"), although these are covered in more detail in the Guidance on Bail-in for International Debt Securities[2] published by the Single Resolution Board.

In relation to the above text, the CNB considers it appropriate to point out that, although this document deals with bail-in implementation, the CNB intends, where appropriate, to proceed by analogy with the implementation of resolution powers and tools other than bail-in, e.g. write-down and conversion of capital instruments and intra-group eligible liabilities.

This document sets out the CNB's currently planned approach to the implementation of bail-in. However, it does not take into account the specific characteristics of individual institutions or the circumstances that may prevail at the time an institution fails. For this reason, the resolution approach applied by the CNB may differ from that described in this document. The resolution framework is subject to continuous refinement, so this document may be further amended in connection with changes in the applicable legislation or with relevant knowledge gained.

[1] Available online at https://www.fsb.org/2018/06/principles-on-bail-in-execution-2/
[2] Available online at https://srb.europa.eu/en/content/guidance-bail-international-debt-securities

General principles and assumptions for the implementation of bail-in

Bail-in implementation is a complex task during which those involved must deal with a wide range of principles and assumptions. This part of the document sets out the most important of them.

Identified stakeholders

Successful implementation of bail-in depends on the preparedness of a broad group of stakeholders. The table below provides an overview of the stakeholders necessary for external implementation, along with their roles and responsibilities in the process.

Stakeholder	Organisation	Main responsibilities
Resolution authority	Czech National Bank	- Preparing and publishing the decision to implement the bail-in - Communicating with FMIs involved in implementing the bail-in - Issuing the order to suspend trading in, or delist, instruments issued by the failing institution - Preparing and publishing the decision to introduce a moratorium - Preparing and publishing the decision to introduce/terminate resolution administration
Failing institution	The institution in resolution	- Communicating with FMIs involved in implementing the bail-in - Preparing instructions and documentation necessary for cancelling selected instruments issued by the institution, issuing new instruments and distributing them to new owners in accordance with the bail-in implementation decision, and forwarding them to the relevant FMIs
Regulated market operator	Prague Stock Exchange Wiener Börse AG Luxembourg Stock Exchange	- Suspending trading in, or delisting, instruments issued by the failing institution
Central securities depository	Central Securities Depository Prague	- Allocating ISINs to newly issued instruments of ownership in accordance with the request - In the case of a moratorium, suspending interest payments and principal repayments - Providing information on securities accounts on which the instruments subject to bail-in ("the instruments concerned") are recorded - Technically implementing the bail-in in the central securities depository's systems (i.e. cancelling/changing the face value of instruments issued by the

		failing institution in accordance with the CNB's decision) - Distributing newly issued instruments of ownership to securities accounts in accordance with instructions received - Informing its participants of changes made to the relevant securities accounts
International central securities depository	Clearstream Banking Luxembourg S.A. Euroclear Bank SA/NV	- In the case of a moratorium, suspending interest payments and principal repayments - Providing information on securities accounts on which the instruments concerned are recorded - Technically implementing the bail-in in the central securities depository's systems (i.e. cancelling/changing the face value of instruments issued by the failing institution in accordance with the CNB's decision) - Informing its customers of changes made to their securities accounts
Paying agent	The paying agent for instruments issued by the failing institution, which is responsible, among other things, for distributing cash to investors	- Preparing instructions and documentation necessary for cancelling selected instruments issued by the institution, issuing new instruments and distributing them to new owners in accordance with the bail-in implementation decision, and forwarding them to the relevant FMIs - Providing information on the bank and securities accounts of holders of the instruments concerned for whom it acts as paying agent
Bail-in agent	An institution whose technical, procedural, managerial and governance capabilities correspond to the scope of the bail-in implementation	- Preparing instructions and documentation necessary for cancelling selected instruments issued by the institution, issuing new instruments and distributing them to new owners in accordance with the bail-in implementation decision, and forwarding them to the relevant FMIs - Providing information on the bank and securities accounts of holders of the instruments concerned - Maintaining a register of the beneficial owners of instruments of ownership and, where applicable, instruments credited to their designated owner account at the CSDP in the course of bail-in implementation

		- Informing beneficial owners for whom it records securities on an owner account at the CSDP in connection with bail-in implementation
Custodian	A financial institution which provides securities custody services to its customers based on their instructions	- Informing its customers of changes made to their securities accounts

Removal from, or suspension of, trading and re-admission to trading

In the event of the failure of an institution whose instruments subject to bail-in have been admitted to trading on a regulated market, the CNB will, in accordance with the applicable legislation and depending on the specific circumstances, require the regulated market operator to remove the instruments concerned from trading or to suspend trading in them on the relevant regulated market.

In order to calm the situation in markets in investment instruments, the CNB may, where necessary, require regulated market operators[3] to remove from trading or suspend the trading of all instruments issued by the failing institution that have been admitted to trading on regulated markets. Alternatively, operators of regulated markets in investment instruments may, at their own discretion and in accordance with their rules, suspend trading in some or all of the instruments issued by the failing institution.

To raise the awareness of market participants and ensure transparency in the process of admission or re-admission to trading of instruments issued by an institution in resolution on regulated markets, the CNB does not intend to use its legislative powers in relation to regulated market operators in the Czech Republic to have newly issued or previously traded instruments admitted to trading on the markets they operate. On the contrary, the CNB considers it appropriate for the application for the admission of instruments to trading on regulated markets to be within the competence of the institution, i.e. the issuer, and for the procedure set out in the applicable legislation to be followed.

Use of interim instruments

The current legal framework does not allow the CNB to use interim instruments in the event of resolution. For this reason, the bail-in implementation method considered in this text involves converting liabilities directly into instruments of ownership of the institution (i.e. ordinary shares).

Cancellation of instruments, conversion into instruments of ownership, and unsettled transactions

In the implementation of bail-in, losses of the failing institution are covered through write-down, i.e. a corresponding reduction in the value of instruments. Instruments may be written down fully or partially in the course of resolution. In the case of full write-down, the value of the instrument is reduced to zero. The instrument expires and is subsequently cancelled in the relevant register.

[3] The CNB may impose the obligation to remove from, or suspend, trading on European regulated market operators, a list of which is available at https://registers.esma.europa.eu/publication/searchRegister?core=esma_registers_upreg

Instruments of ownership, i.e. ordinary shares, may also be fully written down through transfer to creditors from liabilities that were converted into instruments of ownership during the implementation of bail-in.

The restoration of the institution's regulatory capital, i.e. recapitalisation, is carried out by converting liabilities (including accrued interest) into instruments of ownership of the institution in accordance with the conversion rates set out in the CNB's decision. The CNB uses these conversion rates to determine whether the instrument is converted in full or only in part. Fully converted instruments cease to exist at the moment of conversion and are cancelled in the relevant registers. Partially converted instruments do not expire but are reduced in value.

As with write-down, the CNB carries out conversion in accordance with the insolvency hierarchy, i.e. instruments are written down or converted in reverse order of the priority in which their owners would be satisfied in liquidation or insolvency. Also linked to this process is the protection afforded to creditors and shareholders of the failing institution under the resolution framework – that none of them should incur a higher loss than they would have in liquidation or insolvency (the "no creditor worse off" – NCWO – principle). To meet the objectives of the NCWO principle, the CNB will ensure that an independent valuation providing information on compliance with this principle ("Valuation 3") is carried out. Based on this information, the CNB will, no later than one year after the application of the resolution action, decide on any compensation. Only those creditors and shareholders who notify the CNB of their claims no later than six months after the bail-in decision becomes enforceable, using the prescribed form, are eligible for such compensation.[4]

Where bail-in implementation is applied to instruments recorded in a central register, the entity responsible for maintaining the register is instructed to make the required changes directly by the failing institution, the paying agent, or another person designated by the CNB acting as bail-in agent. The entity responsible for maintaining the register of the instruments concerned informs the owners of the instruments, or its participants, of the changes made in the register in accordance with its own rules and the applicable legislation. Where bail-in implementation involves issuing new instruments of ownership of the institution, these are issued and registered at the Central Securities Depository Prague.

To enable the settlement of transactions in the instruments concerned that were traded before removal from trading or suspension, the transferability of these instruments is not restricted or blocked in the relevant central registers (i.e. settlement, including that of suspended transactions, follows the rules and procedures of the relevant central register and settlement system operator).

Addressing differences between the provisional and definitive valuation

The resolution framework requires that resolution tools, or the write-down and conversion of write-downable capital instruments and intra-group eligible liabilities, be implemented on the basis of a definitive valuation, i.e. a valuation that is prepared by an independent valuer meeting the requirements of Chapter IV of Regulation 2016/1075 and that meets all requirements applicable to such valuations under Regulations 2018/345, 2018/344 and 2016/1401.

[4] No later than the day following the publication of the bail-in execution decision, the CNB will publish on its website a call for the submission of claims for compensation under Article 177 of the RRA and make the relevant electronic form available.

Due to urgency or other serious circumstances, the CNB may base its decision to apply a resolution action on a provisional valuation (i.e. a valuation that does not meet all of the above-mentioned requirements). In such cases, the CNB must ensure that a definitive valuation is carried out. This valuation forms the basis for any subsequent CNB decision on the settlement of differences between the provisional and definitive valuations. If, on the basis of the definitive valuation, the CNB concludes that the institution's creditors are entitled to settlement, the CNB will require the institution to pay the creditors the relevant amount in cash. The CNB does not expect settlement to be made through an increase in the value of previously written-down instruments. The CNB also notes that, under the Czech resolution framework, entitlement to settlement can only be granted to creditors who have submitted their claims no later than six months after the bail-in decision becomes enforceable, using the prescribed form.[5]

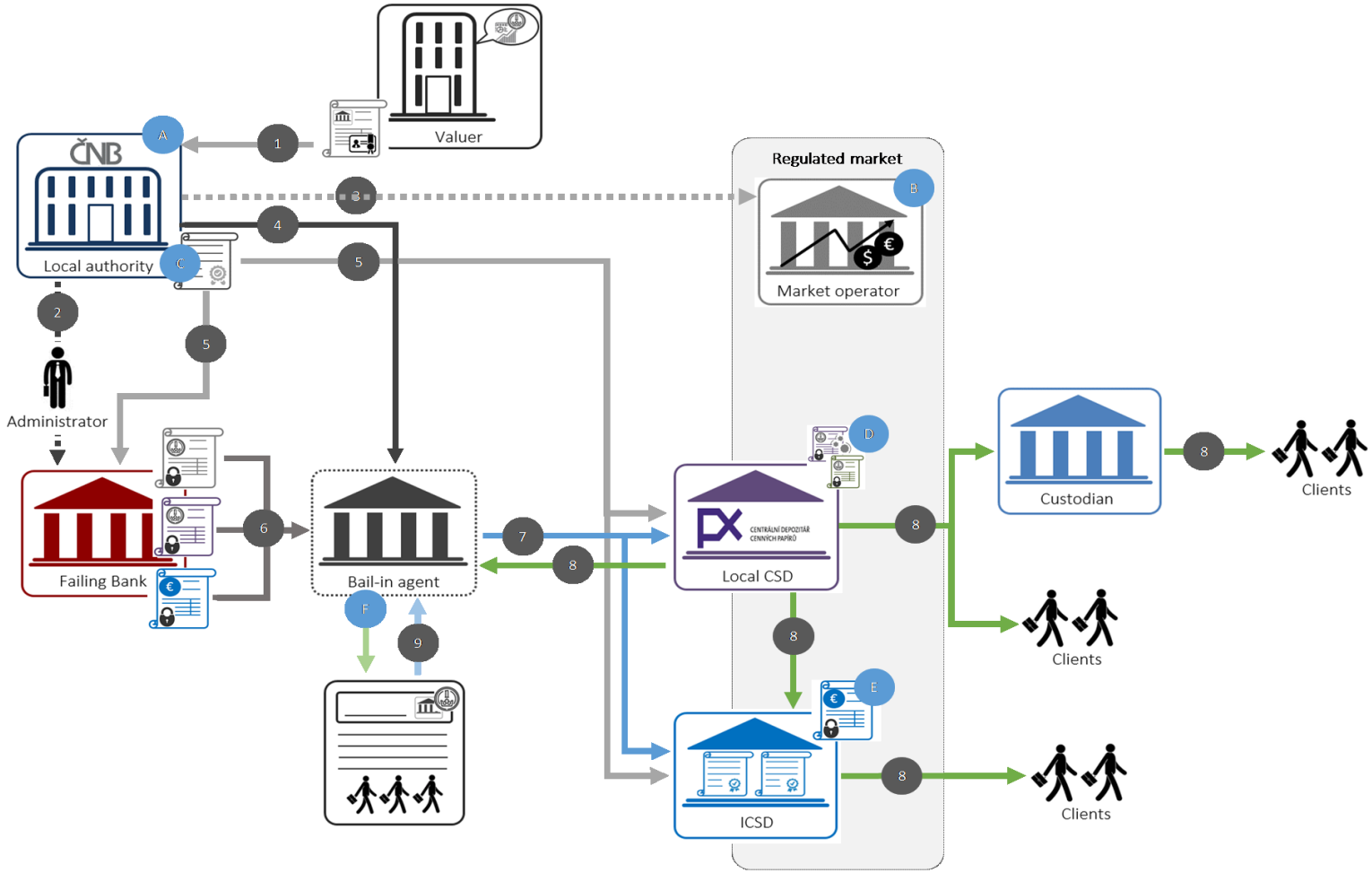
Handling of fractional shares

In its bail-in implementation decision, the CNB will also require the failing institution to issue ordinary shares with specific parameters, e.g. number of units and face value. The Czech legal system does not permit fractional securities to be held on securities accounts at the CSDP. Therefore, when drafting the bail-in implementation decision, the CNB will choose such parameters as to minimise the likelihood that fractional shares would need to be distributed to new shareholders. It is therefore likely that, in the implementation of bail-in, a larger number of shares with a lower face value will have to be issued, and the institution itself may later take steps to align the newly issued shares with the market standard.

However, even this approach does not entirely rule out the possibility of fractional entitlements. Where a conversion would result in fractional shares, the CNB will round them down so that whole shares are always credited to securities accounts at the CSDP. In cases where a single securities account holds securities for multiple owners – such as in the case of a bail-in agent or a custodian – any fractional interests are addressed directly by these CSDP participants in accordance with the rules they apply and with the applicable legislation.

[5] No later than the day following the publication of the bail-in execution decision, the CNB shall publish on its website a call for the submission of claims for compensation under Article 177 of the RRA and make the relevant electronic form available.

Simplified bail-in implementation process



Phase	Step/Action	Responsibility	Timing/Duration	Description of step/action
Preparatory phase (prior to resolution)	1	CNB	4–6 weeks	Before taking resolution action, the CNB will ensure that a valuation of the assets and liabilities of the institution is carried out, to provide information necessary to: a) decide whether the conditions for taking resolution action are met ("Valuation 1") b) determine the appropriate procedure and manner of resolution action to be taken in respect of the institution ("Valuation 2") The valuation must be carried out by a person who has sufficient experience and knowledge in valuing institutions and who is independent of the CNB, any other relevant public authority and the institution pursuant to EU Regulation 2016/1075 ("definitive valuation"). Where, due to urgency or other serious circumstances, it is not possible to conduct an independent valuation, the CNB will ensure that a provisional valuation of the institution's assets and liabilities is carried out, with the independent valuation to be conducted as soon as possible. In relation to the central guiding principle of the resolution framework that no creditor should incur a higher loss than they would have in liquidation or insolvency, the CNB will ensure that an independent valuation providing information on compliance with this principle ("Valuation 3") is carried out.
Resolution (bail-in execution)	A	CNB	D	Based on the information from Valuation 1, the CNB will decide whether the institution is failing or likely to fail ("FLTF"). Subsequently, the CNB will assess whether the conditions for resolution set out in Article 78 of the RRA have been met. Depending on the timing and circumstances of the failure of the institution, the CNB may consider it beneficial to suspend the institution's payment and delivery obligations (i.e. to introduce a moratorium pursuant to Article 83 of the RRA) for a maximum period of two business days. The moratorium may not cover the institution's obligations to payment and settlement systems with settlement finality, and to operators of these systems, central counterparties and central banks.

	2	CNB	D	If the CNB finds it expedient, especially with regard to the requirements applying to members of the institution's governing bodies and the foreseeable changes in the institution's shareholder structure, the CNB will introduce resolution administration in accordance with Article 86 of the RRA. In line with the requirements set out in the RRA, resolution administration may be performed either by the CNB directly or by a special administrator. Upon the imposition of resolution administration, the exercise of the powers of the management bodies and the supreme body of the institution is suspended and their responsibilities are exercised by the administrator. Where resolution administration has been established as part of the resolution process, the CNB will not issue a decision to terminate it until it is clear that the institution's governing bodies are filled by persons meeting the requirements laid down in the applicable legal regulations.
	3	CNB	D	In the event of the failure of an institution whose instruments subject to bail-in ("the instruments concerned") are admitted to trading on a regulated market, the CNB will inform the relevant regulated market operator of the failure of the institution (issuer) immediately after being informed of the institution's failure. Depending on the situation, the CNB will require the regulated market operator to remove the instruments concerned from trading or to suspend trading in them on the relevant regulated market.
	B	Regulated market operator	D	Based on the obligation imposed by the CNB, the regulated market operator, applying its internal procedures, will remove the instruments concerned from trading or will suspend trading in them on the relevant regulated market for the time necessary to implement the bail-in.
	4	CNB	D	The CNB will select an institution whose technical, procedural, managerial and governance capabilities correspond to the scope of the bail-in implementation and entrust it with administering transactions relating to the implementation of the bail-in ("the bail-in agent"). Depending on the scope of the bail-in implementation and on practical experience, in particular in the field of securities processing, settlement and custody services, the

				role of bail-in agent may also be entrusted to the institution subject to bail-in implementation, i.e. the failing institution and the bail-in agent are one and the same.
	C	CNB	D + 2	Based on the information from Valuation 2, the CNB will issue a decision, or a provision of a general nature, implementing bail-in ("the bail-in decision"). The bail-in decision contains in particular the identification of instruments to which the bail-in is to be applied and conversion rates determined in accordance with EBA Guidelines EBA/GL/2017/03 respecting the principle that no creditor will be worse off than in insolvency proceedings and that all creditors within the same class in the insolvency hierarchy are treated equally. The implementation of bail-in may lead to a situation where creditors from the instruments concerned in certain classes in the insolvency hierarchy also contribute to covering the institution's losses through the conversion into instruments of ownership of the institution, i.e. the market value of the instruments of ownership received is lower than the value of their claim arising from the instruments concerned.
	5	CNB	D + 2	Straight after the bail-in decision is issued, the CNB will inform the failing institution, the Central Securities Depository (CSDP) and, where applicable, persons maintaining other (central) securities registers, including international central securities depositories (ICSDs) about its relevant attributes. The CNB's communication will contain, but is not limited to, information on: • the instruments subject to bail-in implementation, including the treatment each instrument is to receive; • the parameters of the instruments to be issued in the process of bail-in implementation (e.g. type, quantity and face value); • the conversion rates for the individual instrument classes, i.e. the rate to be used for conversion into instruments of ownership of the institution. Where bail-in implementation involves issuing new instruments of ownership of the institution, these will be issued and registered at the CSDP.

	6	Failing institution	D + 3	Based on information on the scope and manner of bail-in implementation, the failing institution will prepare all the necessary information and documents and make them available to the bail-in agent or the paying agent.
	7	Bail-in agent/paying agent	D + 4	The bail-in agent/paying agent will process the information and documents prepared by the failing institution into electronic instructions and send them to the CSDP and, where relevant, to the ICSD or other persons maintaining registers of securities, which will execute the bail-in on the instruments concerned.
	D	CSDP	D + 5	The CSDP, on the basis of the electronic instructions received, will carry out the write-down and conversion of the instruments concerned, as a result of which: • the original instruments (whether instruments of ownership or instruments representing the debt of the institution): a) will be cancelled: where these instruments are no longer needed for the successful completion of the bail-in process; or b) their face value will be reduced accordingly: where part of the instruments are to remain issued at the time of bail-in implementation; • the instruments of ownership will be distributed to the creditors affected by the implementation of bail-in. For instruments registered at the CSDP, the CSDP will, in accordance with the instructions received, exchange these instruments for the corresponding number of instruments of ownership directly on the owners' accounts where the instruments are registered at the time of bail-in execution. For instruments registered at the ICSD, the CSDP will, in accordance with the instructions received, credit the corresponding number of instruments of ownership to the owner's account of the relevant ICSD. For instruments registered in other records or registers, the CSDP will, in accordance with the instructions received, credit the corresponding number of instruments of ownership to the designated owner's account of the bail-in agent.
	E	ICSD	D + 5	The ICSD, on the basis of the instructions received, will carry out the write-down of the instruments concerned, as a result of which: • the original instruments:

				a) will be cancelled: where these instruments are no longer needed for the successful completion of the bail-in process; or b) their face value will be reduced accordingly: where part of the instruments are to remain issued at the time of bail-in implementation • the corresponding number of instruments of ownership will be credited to the relevant owners' accounts in the follow-up records maintained by the ICSD.
After resolution	8	CSDP/ICSD/custodian	D + 5	The CSDP, using the standard means of communication, will inform the owners' accounts' beneficiaries about the changes or movements on owner's accounts. The owners' accounts' beneficiaries will subsequently inform their clients about these changes.
	F	Bail-in agent	D + 5	The bail-in agent, based on information and documents from the failing institution, will maintain a list of beneficial owners of the instruments of ownership that have been credited to the designated bail-in agent's owner's account with the CSDP. The bail-in agent will inform the beneficial owners for which it has records of securities connected with the implementation of bail-in on an owner's account with the CSDP, and will invite them to provide instructions according to which these securities will be transferred to the corresponding owners' account (held either directly with the CSDP or in the follow-up records).
	9	Owners of instruments of ownership	> D + 5	Owners of instruments of ownership that are held in their favour on the bail-in agent's owner's account will instruct the bail-in agent to transfer the corresponding number of securities to the owners' accounts of their choice.