



NOTE

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Attachment - Response by the Danish government to questions in the discussion paper on the debt write-down tool - bail-in – put forward by the Commission

Question box 1- Point of entry into resolution

In the discussion paper the Commission raises a question on when the debt write-down tool should be at the disposal of the authorities, if the tool is introduced in the directive.

We agree that the debt write-down tool should be introduced in the coming directive, and support the view put forward by the Commission that the trigger point for the use of the debt write-down tool should be the point where the institution is in breach of the capital requirements including the pillar 2 capital requirements.

In that regard it is very important that the trigger point is well defined, predictable and transparent so that the securities can be rated and priced with sufficient clarity in order to secure demand.

Especially when it is a breach of the pillar 2 capital requirements that leads to the use of the debt write-down tool, it is essential that the scheme firmly ensures that property rights are protected. In the current resolution scheme in Denmark this is solved through voluntariness.

Question box 2 – Purpose of the debt write-down tool

The Commission suggests that the debt write-down tool could be available in both an open bank and a closed bank scenario and that resolution authorities should be entitled to use the tool for the purpose of capitalising a bridge bank (closed bank scenario) or recapitalising an institution (open bank scenario).

Denmark has experiences only with the use of the debt write-down tool in a closed bank model and we have not yet taken a position on how the debt write-down tool can be used in an open bank model.

However, we welcome the introduction of a possibility to use the debt write-down tool in an open bank model as well.

We reserve our views on the functioning of the bail-in instrument in an open bank model, but we would none the less recommend that a higher trigger point should be considered in order for the open bank bail-in to have a practical use.

Question box 3 – Scope of the debt write-down tool

In the discussion paper the Commission highlights the need to be clear and precise as to which liabilities would be subject to the debt write-down power. In addition, the Commission states that a number of liabilities should not be subject to debt write-down. Especially secured liabilities and short-term liabilities with an original maturity of less than one month are highlighted as liabilities that could be exempted from the scope of debt write-down tool.

Covered bonds (and financial instruments concluded to hedge risks in the cover pool) are secured liabilities. The EU financial regulation is based on the fact that covered bonds are very high quality assets allowing e.g. for larger exposures herein. As a logical consequence hereof, we find that covered bonds explicitly should be exempted from the scope of the debt write-down tool. Furthermore, such secured liabilities have, according to UCITS and to Danish law, been granted a preferential treatment in case of bankruptcy.

In addition to covered bonds the Danish resolution scheme also exempts salaries from the debt write-down tool. Therefore, from a Danish point of view, salaries should also be exempted from the scope of the debt write-down tool.

Furthermore we do not support the suggestion put forward by the Commission to exempt short-term liabilities with an original maturity of less than one month.

This is based on the view that it is extremely important that the ordinary bankruptcy order is fully respected. Furthermore, counterproductive incentives to invest in short term liabilities that are exempted from debt write-down should be avoided, since this is in contradiction to the intentions of the coming liquidity regulation in CRR IV.

Question box 4 – Hierarchy of claims

The Commission raises a question on the hierarchy of claims and the treatment of derivatives in connection to the use of the debt write-down tool.

From a Danish point of view, we find it extremely important that in a bail-in procedure the ordinary bankruptcy order is fully respected, as mentioned in connection to question box 4.

As a consequence hereof the Danish resolution scheme does not exempt unsecured derivatives from debt write-down and we would prefer that this would also be the case under the harmonised resolution regime.

Question box 5- Minimum requirements for eligible liabilities

Denmark is in favour of requiring institutions to hold a minimum amount of bail in-able debt in order to secure the sufficient loss absorbing capacity and to counter the adverse incentive-effects arising from a possible exemption of certain kinds of debt. On a general level, Denmark tends to be in favour of option 1, but cannot, however, at this point in time decide on a desirable minimum level of eligible liabilities. In our view it must first be established which, if any, types of liabilities will be excluded from debt write down.

Covered bonds are secured by assets that in terms of capital requirements may weigh less than 100 %. Consequently the credit institution may hold less capital to back this business activity than they have to hold for ordinary lending activities. The EU financial regulation in itself is based on the fact, that covered bonds are very high quality assets allowing e.g. for larger exposures herein. Therefore we also find that covered bonds should be exempted from the scope of the debt write-down tool cf. question box 3 above. As a consequence hereof covered bonds should also be exempted from the eligible liabilities requirements.

Question box 6 – Treatment of shareholders

The Commission raises a question on the treatment of shareholders under the resolution regime.

In this connection we would like to stress the view that the ordinary bankruptcy order should be fully respected. This implies that the resolution regime should not provide for a protection of shareholders. We therefore find that there should be an absolute obligation to cancel existing shares under a closed bank model.

Denmark has not yet, however, taken a position on how the debt write-down tool can be used in an open bank model and what the consequences for existing shareholders should be.

Question box 7 – Recovery and reorganising measures to accompany debt write-down

In the discussion paper the Commission proposes that detailed resolution and/or reorganisation plans should be prepared for all institutions covered by the directive. We find resolution and/or reorganisation plans extremely important when it comes to systemically important financial institutions. However, it can also be a sound instrument for smaller institutions.

It is not clear from the discussion paper, whether the requirement on the preparation of resolution and/or reorganisation plans is an ex ante requirement or an ex post requirement.

We would like to stress that the requirement to prepare resolution plans can lead to a significant administrative burden for the institutions in question as well as for the resolution authority. This is especially the case if the Commission intends to introduce the measure as an ex ante requirement.

We would therefore suggest that the requirement is introduced on a proportionate basis allowing authorities to exempt small credit institutions from the requirement.

In addition, we find that the level of details in resolution and/or reorganisation plans should be considered, since it will be very difficult to foresee and take into account the financial situation at the time of the resolution or reorganisation of the institution.

It is particularly important to have focus on the liquidity part of the recovery plan, since bail-in as a resolution tool does not provide liquidity per se and merely restores the capital solution which is a basis for a possible improved liquidity position. It is therefore of great importance that credible liquidity mitigating provisions are in place.

Finally we would like to stress that we have not yet taken a position on when the resolution and/or reorganisation plans should be presented.

Question box 8 – Contractual recognition of debt write-down

The Commission raises a question on the treatment of eligible liabilities that are governed by the law of a jurisdiction that is not a Member State of the European Union.

We have not yet taken a position on this issue and we are therefore not able to provide an answer to the question raised.

Question box 9 – Timing for the application of the debt write-down tool

As a final point the Commission raises the issue of introducing a grandfathering clause in the directive.

From a Danish point of view the introduction of a grandfathering clause would limit the usefulness of introducing the debt write-down tool, since it would cause a risk that credit institutions would try to avoid the risk of debt write-down as long as possible. This could cause that large amounts of liquidity are to be refinanced simultaneously. Furthermore such a

grandfathering mechanism would limit the scope of the bail in-able securities with a marked price-impact on debt issued after the cut-off date.

We therefore do not support the introduction of a grandfathering clause in the directive.