



Council of the European Union
General Secretariat

**Interinstitutional files:
2023/0112 (COD)**

Brussels, 27 October 2023

WK 13971/2023 INIT

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| From: | Presidency |
| To: | Working Party on Financial Services and the Banking Union (CMDI) Financial Services Attachés |
| N° Cion doc.: | ST 8482 2023 INIT |
| Subject: | 31.10.2023 - CMDI Working Party Commission non paper on liabilities of uncertain timing or amount |

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Commission services' note on elements related to the treatment of liabilities of uncertain timing or amount in a bail-in

1. Background

The BRRD provides that the bail-in tool may be applied to all liabilities of an institution, or a group entity, except those that are either statutorily excluded from the bail-in scope under Article 44(2) BRRD or by the resolution authority pursuant to Article 44(3) BRRD.

The term “liability” is not defined in the BRRD or SRMR. This fact has created uncertainty as to whether all liabilities, including liabilities of uncertain timing or amount, would be in scope of the bail-in tool.

An indication of their possible inclusion was to be found in recital 16 of Commission Delegated Regulation (EU) 2016/860 of 4 February 2016 specifying further the circumstances where exclusion of the liabilities the amount of which is not determined or is difficult to determine at the point of resolution from the application of write-down or conversion powers is necessary under Article 44(3) of BRRD.¹

This mention seemed to imply that those liabilities were in scope and not to be exempted from bail-in. However, it was the only reference to be found in the BRRD framework and it did not provide any specific element regarding the operationalisation of the bail-in of such liabilities.

In this context, the issue of the bail-inability of those liabilities was discussed in 2019 in various fora of the EBA, including the Resolution Committee and the Subgroup on Resolution Execution. The advantages and drawbacks of the bail-in of such liabilities and the related legal and practical issues were examined in-depth, but no definitive conclusion was reached.

However, the existence of those liabilities gives rise to challenges for resolution authorities, creating litigation risk and risks of underestimating the amount of bail-in needed in case the losses

¹ This recital states: “*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.*”

arising from those liabilities crystallise at a later stage. Therefore, the Commission considered that it was necessary and appropriate to provide directly in the legal text for a specific treatment of liabilities of uncertain timing or amount in case of use of the bail-in tool.

2. New provisions proposed

Some contingent liabilities correspond to commitments that, if acted on, will result in creation of an asset on the balance sheet of the institution. This is the case for contingent liabilities that, if they materialise, do so in the form of loans provided by the institution concerned, such as irrevocable lines of credit, undrawn overdrafts, or similar facilities. Those do not need to be addressed from a bail-in perspective because they do not generate a liability.

The Commission, building on the reflection at the EBA, proposes to differentiate among other types of liabilities of uncertain timing or amount using the classification used in the IAS 37².

IAS 37 distinguishes two types of contingent liabilities:

2.1 Provisions

According to IAS 37, an (accounting) provision is a liability of uncertain timing or amount.

It is recognised in the financial statements only when:

- a) an entity has a present obligation (legal or constructive³) as a result of a past event;
- b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- c) a reliable estimate can be made of the amount of the obligation.

As provisions are recognised in the financial statements, they result in the existence of items on the balance sheet to which the bail-in tool may be applied with the requisite degree of certainty.

Therefore, the Commission suggests in its proposal to add in the BRRD⁴ an explicit mention that accounting provisions are among the liabilities that may be bailed in. As for any other bail-inable liabilities, possible exemptions will have to be assessed on a case-by-case basis.

Amendments to this end are made to Article 2, point (71a), Article 44 (1) BRRD and Article 53(3) BRRD as follows:

² IAS 37: <https://www.ifrs.org/content/dam/ifrs/publications/pdf-standards/english/2021/issued/part-a/ias-37-provisions-contingent-liabilities-and-contingent-assets.pdf> It was adopted in the EU by [Commission Regulation \(EC\) No 1126/2008 of 3 November 2008 adopting certain international accounting standards in accordance with Regulation \(EC\) No 1606/2002 of the European Parliament and of the Council](#)

³ The standard defines a constructive obligation as “an obligation that derives from an entity’s actions where: (a) by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; (b) as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.”

⁴ Relevant changes are mirrored in the SRMR.

Article 2

(71) 'bail-inable liabilities' means the liabilities, **including those giving rise to accounting provisions**, and capital instruments that do not qualify as Common Equity Tier 1, Additional Tier 1 or Tier 2 instruments of an institution or entity as referred to Article 1(1), points (b), (c) or (d), and that are not excluded from the scope of the bail-in tool pursuant to Article 44(2);'

Article 44

1. Member States shall ensure that the bail-in tool may be applied to all liabilities, **including those giving rise to an accounting provision**, of an institution or entity referred to in Article 1(1), points (b), (c) or (d), that are not excluded from the scope of that tool pursuant to paragraphs 2 or 3 of this Article.'

Article 53

3. Where a resolution authority reduces to zero the principal amount of, or outstanding amount payable in respect of, a liability, **including a liability giving rise to an accounting provision**, by means of the power referred to in ~~point (e) of~~ Article 63(1), **point (e)**, that liability and any obligations or claims arising in relation to it that are not accrued at the time when the power is exercised, shall be treated as discharged for all purposes, and shall not be provable in any subsequent proceedings in relation to the institution under resolution or any successor entity in any subsequent winding up.

2.2 Contingent liabilities

A contingent liability under IAS 37 is:

- a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or
- b) a present obligation that arises from past events but is not recognised because:
 - i. it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
 - ii. the amount of the obligation cannot be measured with sufficient reliability.

Unlike provisions, contingent liabilities are not recognised in the financial statements but disclosed in the notes to the accounts.

This means that they would not result in accounting items that would be possible to bail-in without quantifying their value at the point of resolution. However, the risk from their existence, in

particular the risk that they could jeopardise the post-resolution stabilisation by giving rise to losses that materialise during the restructuring period, should be mitigated.

To this end, in line with some of the approaches discussed at the EBA, as well as the spirit of recital 16 of Commission Delegated Regulation (EU) 2016/860 of 4 February 2016 and in a logic similar to the one underpinning the requirement for a buffer for additional losses in case of provisional valuation⁵, the Commission proposes to require the valuer to appropriately take into account the existence of contingent liabilities in their valuation and the resulting amount that it may be necessary to bail-in.

The two amendments proposed, combined, would ensure that an appropriate and sufficient amount of liabilities is bailed-in, in order to adequately cater for any potential losses in case any of those liabilities were to crystallise in the future.

The amendments proposed are the following:

Article 36, new paragraph 7a:

7a. Where necessary to inform the decisions referred to in paragraph 4, points (c) and (d), the valuer shall complement the information in paragraph 6, point (c), with an estimate of the value of the off-balance sheet assets and liabilities, including contingent liabilities and assets.

Article 46(2):

2. The assessment referred to in paragraph 1 of this Article shall establish the amount by which bail-inable liabilities need to be written down or converted:

(a)** in order to restore the Common Equity Tier 1 capital ratio of the institution under resolution or where applicable establish the ratio of the bridge institution taking into account any contribution of capital by the resolution financing arrangement pursuant to **point (d) of Article 101(1), point (d),** of this Directive; **and

***(b)** to sustain sufficient market confidence in the institution under resolution or the bridge institution, **taking into account any contingent liabilities,** and enable **the institution under resolution** to continue to meet, for at least **1** year, the conditions for authorisation and to continue to carry out the activities for which it is authorised under Directive 2013/36/EU or Directive 2014/65/EU.*

⁵ Article 36(9) BRRD