“Bail-in” and Special Resolution
Financial Markets Group, London School of Economics
Minute of a Workshop on March 14, 2011

Recently a Trans-Atlantic group of experts met at the London School of Economics to discuss “Bail-in” and other ideas recently developed that aim at addressing the too-big-to-fail problem by increasing the efficiency of tools available to authorities in resolving distressed, systemically important financial institutions (SIFIs). The group involved senior academics, bankers, investors, lawyers, and regulators representing a wide variety of perspectives on the issues. Nevertheless, after extensive discussion a good degree of common view emerged on many topics. Some of those present felt it would be useful to record propositions that command broad support. This minute is meant to take note of the main points of common view that emerged at the workshop.

1. A “bail-in” regime or arrangement is intended to facilitate the resolution of a SIFI (which for short we refer to as a “bank”) in a manner that avoids losses to taxpayers by triggering the write-down or conversion of selected categories of unsecured, uninsured debt to common equity while preserving the bank’s viable business and restructuring the unviable parts.
2. To be effective, the bail-in needs to be done in such a manner as to avoid formal default of any of the contractual obligations of the bank which otherwise would trigger liquidation and fire sales.
3. To achieve this end, a bail-in needs to have a legal basis in a special resolution regime that gives clear responsibility to a competent authority who is empowered to act in a timely manner.
4. To achieve legal certainty and to not be susceptible to numerous legal challenges, a bail-in regime needs to provide for cross-border recognition, possibly through contract, of a statutory bail-in power exercised by a home authority.
5. To be a credible resolution tool for SIFIs and Global SIFIs (GSIFIs), it must extend to holding companies and relevant subsidiaries.
6. For GSIFIs care needs to be taken to assure that the debt subject to bail-in for regulatory purposes is free from ‘ring-fencing’ arrangements that might be applicable to subsidiaries in other jurisdictions. This needs to be clarified and addressed *ex ante*, possibly through a recovery and resolution plan.
7. The major elements of the design of a bail-in regime include:
    a) A determination of what debts are subject to bail-in and what debts are not;
    b) The definition of the bail-in trigger; i.e., the conditions under which bail-in debt is converted to equity;
    c) When applicable, the conversion ratio, that is the number of common shares received for a given amount of debt.
8. There is no single design that is clearly best. Indeed it is likely that different designs may give rise to similar results in practice. The question of good design should be the subject of further study by academics but also should be adapted to experience in the market place and in real resolution experience.

9. However, there is broad agreement that a good design must meet several criteria:
    a) It should avoid large 'cliff effects' that might otherwise invite speculative attacks.
    b) To be robust in dealing with the wide range of possible forms of distress, the bail-in regime must allow for regulatory discretion.
    c) However, discretion should be limited and should not include discretion to make previously exempted debt subject to bail-in conversion.
    d) As a discipline against possible regulatory forebearance, there may be a role for use of market-based indicators in arriving at the regulatory decision to invoke bail-in.
    e) The existence of a bail-in regime should help to improve incentives to raise capital before bail-in is reached.
10. Bail-in could be an important addition to the tools available to regulatory authorities in addressing the too-big-to-fail problem. This should be reinforced with progress in bringing greater resiliency to key markets and in the development of macro-prudential tools.

The participants of the March 14 workshop were:

Viral Acharya, Stern School of Business, New York University; Ron Anderson, London School of Economics; Hugo Banziger, Deutsche Bank; Peter Brierley, Bank of England; Charles Calomiris, Columbia University; Howard Davies, London School of Economics; Doug Diamond, Chicago Booth; Wilson Ervin, Credit Suisse; Xavier Freixas, University Pompeu Fabra; Simon Gleeson, Clifford Chance; Charles Goodhart, London School of Economics; Seth Grosshandler, Cleary Gottlieb Steen and Hamilton; Eva Hupkes, Financial Stability Board; Tom Huertas, Financial Services Authority; Stefan Ingves, Swedish Riksbank; Kevin James, Bank of England; Malcolm Knight, Deutsche Bank; Chris Lucas, Barclays; Sylvie Matherat, Banque de France ; Ceyla Pazarbasioglu, IMF; Christopher Polk, London School of Economics; Patrick Raaflaub , FINMA; Hal Scott, Harvard University; Richard Stones, UK Independent Commission on Banking; Paul Tucker, Bank of England; David Webb, London School of Economics; David Wright, Oxford University; Kathy Yuan, London School of Economics; Jean-Pierre Zigrand, London School of Economics

The workshop was organized by Ron Anderson and Malcolm Knight who have jointly prepared this minute.