

Decree № 241/04

The Rule on recapitalization of a commercial bank in resolution by means of write-down or conversion of bank's liabilities

Article 1. General Provisions

1. The purpose of the rule is to determine the rules and conditions for the application of bail-in tool provided for in the article 37¹⁰ of the Law on the Activities of Commercial Banks, in order to achieve commercial bank recapitalization objectives, including issues related to the needs of calculation, valuation, determining of conversion rates, developing, agreeing and implementing an action plan necessary to achieve compliance of eligible liabilities and equity instruments provided for in the same article of the Law on the Activities of Commercial Banks.
2. The National Bank of Georgia (National Bank) is authorized to use the resolution tool defined by this Rule:
 - a) To recapitalize failing commercial bank;
 - b) When using the bridge bank tool, for recapitalization of bridge bank;
3. Beyond the rule, all other relevant issues are referred to best practices and guidelines of Financial Stability Board (FSB) and the European Banking Authority (EBA).
4. The terms used in this Rule have the same meanings as indicated in the Law on Commercial Banks Activities (CBA) and in the legislation of Georgia.

Article 2. Decision making procedure on application of the resolution tool

1. The decision maker on selection of the resolution tool defined by this rule, is Resolution Committee within National Bank (Resolution Committee), which determines terms and grounds for use of the resolution tool, the amount of liabilities subject to write-down/ conversion, also liabilities unable to bail-in (due to article 3), amount of regulatory capital to maintain CET ratio of a commercial bank, and in the case of a bridge bank to comply with initial equity requirements, in which case the National Bank shall take into account the amount of temporary state funding and the resources necessary to restore market confidence to the bank /bridge bank and to comply with the license requirements of the bank/bridge bank for at least the next 1 year.
2. Decision specified in Article 1 is based on the accounting of bank's assets and liabilities performed in accordance with accounting and prudential supervisory requirements specified in "Rules for Valuation of Commercial Bank Assets and Liabilities for the

Purposes of the Resolution” approved by the Decree of the Governor of the National Bank of Georgia №128 / 04 of June 29, 2020.

3. While using bail-in tool for a bank in resolution regime, in the front line of the order should be set liabilities where contractual terms explicitly states bail-inability and conversion into common shares.

Article 3. Scope of the bail-in tool

1. Bail-in applies liability segments/pools, which has reverse order (bottom-up) than used in liquidation regime in accordance with the requirements defined by CBA Law and this article.
2. National Bank is authorized to bail-in those liabilities having no explicit stipulations in the contracts about bail-inability, except excluded liabilities defined with the rule.
3. Following liabilities have waiver in terms of bail-in eligibility:
 - a) Covered deposits due to Law on Deposit Insurance System (DIS);
 - b) Payables towards DIS;
 - c) Liabilities to tax and social security authorities;
 - d) Liabilities due to Client's assets;
 - e) In respect of a liability secured by a property right, within the value of that security;
 - f) Liabilities (payables) to bank employees, except incentives above remuneration of bank administrators;
 - g) Liabilities to clearing and payment systems - with a validity period of less than 7 days;
 - h) Liabilities to other banks (except banks within the same banking group) - with a validity period of less than 7 days;
 - i) Liabilities due to accounts payables towards service providers of services (including, information technology, utilities, rental and other technical services) critically important for day-to-day operations maintenance.
4. Waiver of bail-in tool is eligible for covered deposits, but only up to coverage limit defined by DIS law.
5. Bail-in waiver also excludes liabilities deriving from variable remuneration of material risk takers at commercial bank.
6. While assessing bail-in waivers to accounts payables towards bank service providers provided for in subparagraph “i” of paragraph 3 of this article, National Bank considers level of importance of that service for the Bank's functioning and day-to-day operations and takes into consideration the following factors:
 - a) Whether relevant property or services will be necessary for maintaining going concern of the bank post resolution;
 - b) Whether application of bail-in tool (defined by this rule) to the existing liabilities towards relevant property (for example rent) or services, cause further disruption of that service continuity;

- c) Whether it is possible to substitute above mentioned outsourced services by third parties, in reasonable time and efficiently, in accordance with the “Rule for Defining and Evaluating Critical Functions of a Commercial Bank” approved by the President of the National Bank of Georgia №129 / 04 of June 29, 2020.
- 7. National Bank is authorized, in addition to the liabilities specified in Article 3, consider bail-in partial or full waiver for those liabilities, where one or multiple pre-conditions are met:
 - a) Despite efforts of National Bank, it is impossible to use the bail-in tool within reasonable timeframe;
 - b) It is necessary and proportionate to maintain the critical functions and core business of the Bank in resolution regime, to ensure continuity of the Bank's core operations, services and transactions;
 - c) It is necessary and proportionate to mitigate spreading of financial difficulties to other participants of the financial sector;
 - d) To maintain NCWO principle;
- 8. Decision on partial or full exclusion of liabilities provided for in article 7 from bail-in list, is made by the Resolution Committee, which secures the following:
 - a) The principle that Creditors take loss after shareholders and there is bail-in order reversely to repayment order defined by liquidation procedure, except cases embedded in Article 37¹¹ of the Law of Georgia on Commercial Banks;
 - b) Bank's loss absorption ability/capacity, if certain liability or liability pool to be excluded from bail-in scope;
 - c) Maintenance of resolution financing sources;
 - d) When using the Bank's bail-in tool for recapitalization, the National Bank shall treat tier II capital instruments that are fully participated at amortized cost, in accordance with the law.

Article 4. Minimum requirement for eligible liabilities and equity instruments (MREL)

- 1. National Bank is authorized to impose MREL, which is a percentage out of regulatory capital and total liabilities.
- 2. In order to be classified as eligible liability the instrument should meet the following criteria:
 - a) Must be issued and fully paid up;
 - b) Should not be a liability to the bank, should not be collateralised or guaranteed by the bank;
 - c) There should not be provided direct or indirect financing by the bank, related to the eligible instrument transaction;
 - d) The maturity of its payment should not be less than one year;
 - e) The obligation should not be originated from a derivative;
 - f) Liability should not be related to the requirement provided for in Article 37¹², point 10, sub-point “k” of CBA Law.

3. In the case provided in subparagraph “d” of paragraph 2 of this Article, if the claim holder has the right to withdraw the instrument before due date, maturity of the instrument should be deemed as the date of first occurrence of that right.
4. If the instrument is subject to foreign law and jurisdiction, National Bank is authorized to require the bank to certify that in the event of write-down or conversion of the instrument, it will be enforceable under foreign law, subject to the terms of the instrument contract and other relevant matters. In case of confirmation absence on the commitment, such instrument should not be qualified as an eligible liability.
5. In order to determine MREL, resolution division of National Bank carries out consultations with the banking supervision department and makes decision based on at least the following criteria:
 - a) Selection and combination of resolution tools, including bail-in tool for recapitalization purposes, in order to achieve efficient resolvability;
 - b) Determination of MREL that will be used to write-down or convert liabilities in resolution process, to ensure compliance with Bank's licensing requirements for at least 1 year, the continuation of the bank's activities and the restoration of market confidence to it (including exclusion of non-eligible liabilities);
 - c) Bank size, business model, funding model and risk profile;
 - d) Impact of Bank's severe illiquidity or insolvency on system-wide financial stability;
6. The requirement imposed under this Article should be met by the Bank on an ongoing basis and individually.

Article 5. Determination of MREL volume

1. National Bank determines threshold of regulatory capital to be supported via bail-in and which is needed:
 - a) To protect the Bank's CET established by legal act or set by the National Bank;
 - b) In the case of a bridge bank - to maintain the capital ratios established by legal act.
2. In the case provided for in point 1 of this Article, volume of temporary state funding, market confidence recovery and licensing compliance for minimum 1 year should be considered, when defining the minimum capital requirements.
3. National Bank determines volume of eligible liabilities for bail-in purposes in accordance with the Rule on Valuation of Commercial Bank Assets and Liabilities for the Purposes of the Resolution approved by the President of the National Bank of Georgia №128 / 04 of June 29, 2020.
4. If the volume of bailed-in liabilities was determined via interim valuation by National Bank (in accordance with the “Resolution on the Valuation of Commercial Bank Assets and Liabilities”), and later, the valuation by an independent valuer found that the amount of written-down and/or converted liabilities exceeds the required amount, then National Bank is authorized to carry out one of the following actions in compliance with the principle set in paragraph 1 of Article 3 of this Rule:
 - a) Partial or full increase in the principal amount of the written-down/cut liabilities up to the amount of the initial principal amount;
 - b) Increase in shares and/or other ownership instruments transferred to the holders of written-down/cut liabilities.

- c) MREL determination should be done by National Bank on the basis of updated and detailed information, where possible.

Article 6. Treatment to shareholders and other instruments owners while using bail-in tool

1. National Bank is authorized to take the following actions against shareholders and/or other instruments owners of the Bank by using the bail-in tool:
 - a) Abolish existing shares and/or other ownership instruments or transfer them to creditors against whom a resolution tool has been applied;
 - b) In order to minimize the share of the shareholders of the bank, in case of the positive equity balance, authorized to convert the instruments of regulatory capital and/or liabilities into ordinary shares or other instruments of possession of the bank.
2. The actions provided for in point 1 of this Article may be applied to the shares referred to in point 3 of Article 2 of this Rule, in which the conversion of liabilities was carried out before the introduction of the resolution or after the write-down of shares and/or other equity instruments or after the conversion of those instruments into shares or other equity instruments.
3. The conversion provided in this Article should be carried out at such a rate as to minimize the existing shareholder shares, which implies a reduction in both the dilution of shareholders' shares and the value of those shares.
4. While executing actions defined by this Article, National Bank, besides the valuation provided for in the Rule on Valuation of Commercial Bank Assets and Liabilities for the Purposes of the Resolution (approved by the President of the National Bank of Georgia №128 / 04 of June 29, 2020), takes into account the amount of shares/other instruments written-down or converted into shares/other equity instruments provided in point 2 of this Article, and the amount of eligible liabilities to be written-down or converted into other instruments (bailed-inable) specified in Article 5 of this Rule.
5. If the direct/indirect participation of a person or partners (shareholders) acting in concert or the beneficial owner, in the bank's capital exceeds 10, 25 or 50 percent as a result of using the recapitalization instrument through write-down or conversion of liabilities, National Bank considers acquisition in accordance with the simplified procedure stipulated by Article 8¹ of CBA law and "Rule on Simplified Acquisition Procedures for the Purchase of a Significant Share of a Bank in Resolution regime" approved by the Governor of the National Bank, 130 / 04 of June 29, 2020.
6. While using recapitalization instrument to write-down or convert a bank's liabilities in resolution regime (bail-in tool), proper liabilities are written-down or converted into equity in the reverse order of the liquidation claims, in accordance with the requirements of Article 3 of this Rule. If certain pool of liabilities/creditors are not subject to full write-down or conversion, their bail-in should be done in proportion to the volume of each creditor's claim in that pool.
7. At first all liabilities of each series/pool of creditors should be utilized fully in terms of bail-in and only afterwards should be next pool applied.

Article 7. Treatment to derivatives when using a bail-in tool

1. Liabilities originated from derivative may be written-down or converted into equity, only after their netting.
2. National Bank is authorized to exercise any termination and / or the netting of derivative contracts in accordance with the rules established by the legislation of Georgia.
3. Where derivative transactions are subject to a netting agreement, the liability derived from the derivative should be determined by its net worth under the terms of the contract, by independent Valuer responsible for the valuation or by National Bank in accordance with the Regulation N128/04 (Valuation Rule)

Article 8. Liability holders' claim rights and issuance of new shares

1. Resolution Committee decides conversion of liabilities into issuing shares, within the frame of which the Committee determines the rights of claim holders, on which President of National Bank issues an individual administrative-legal act.
2. Right of claims defined in this article is of disposable/transferable nature. In addition, resolution committee is authorized to additionally define other conditions and features of the rights of the claims in the decision specified in point 1 of this article.
3. In order to effectively conduct the process set in this Article and, if necessary, to specify the claim holders to the Bank, National Bank may, by public notice, request proof of claims ownership, for which National Bank shall specify proper deadline. Upon the expiration of this period, National Bank ends to receive notifications with supporting documents from the claim holders, unless some holders clarify solid reasoning of application delay.
4. Resolution Committee is authorized to decide issuance of new shares in order to effectively execute resolution objectives in line with the rule on issuance of new shares for the purpose of recapitalization of bank in resolution.

Article 9. Determination of liabilities conversion rates into shares and exchanging claim rights in shares

1. While using bail-in tool, National Bank is authorized to set different rates for the conversion of liabilities into shares and/or other equity instruments in accordance with the principles of the resolution defined by CBA law, taking into account at least one of following principles:
 - a) Conversion rates of liabilities into the equity and/or other equity instruments should adequately compensate each creditor for the loss caused by use of the instrument specified in this point (bail-in), in accordance with the principles of the resolution established by CBA law;
 - b) The conversion rate of liabilities into equity and/or other equity instruments should secure relevance of the liability pool/order (given the dominant and subordinate nature of the liability).
2. In order to transform claim rights into shares, specified in Article 8 of this Rule, National Bank determines deadline for that exchange. The deadline may be prolonged

for 1 month, after the expiration of which claim holders passes the opportunity to exchange the claim rights into new shares.

3. Upon expiration of the period specified in point 2 of this Article, National Bank secures storage of issued shares and placement of relevant proceeds for a reasonable timeframe, if claim holders (if any) appears with sufficient proof of ownership.

Article 10. Action plan by Commercial Bank

1. Within 1 month after the use of the resolution tool defined by this rule, National Bank is authorized to require the bank to draw up, submit and implement an action plan. The action plan should include long-term improvement measures, based on reasonable assumptions about macro economic environment and financial sector outlook.
2. In special cases, if necessary for sustainable resolution objectives, National Bank is authorized to extend determined deadline specified in point 1 of this Article, to 2 months.
3. Administrators of the bank (if any) or special manager introduced by CBA Law are responsible for the development of the action plan.
4. The action plan should include measures to be taken within a reasonable timeframe, in order sustainably improve bank's overall performance, considering assumptions of macro economic environment and financial sector outlook.
5. The action plan must meet at least the following criteria:
 - a) Plan should comprise assessment of challenges and opportunities in financial sector, in terms of particular bank business strategy rethink and planning;
 - b) Plan should assume and analyze system-wide and idiosyncratic scenarios in line with its relevancy;
 - c) Plan should aim to identify key difficulties and impediments of the bank in resolution regime.
6. Action plan should include at least the following elements:
 - a) Detailed analysis of the factors/events that led to the distress of the bank and grounds that introduced resolution regime;
 - b) Detailed description of measures, necessary to be taken for achieving post resolution stabilization of the bank, in reasonable timeframe;
 - c) Timeline for the execution of the measures described above.
7. Measures outlined in subparagraph "b" of paragraph 6 of this article should include at least:
 - a) Re-organization of the bank's business;
 - b) Modifications to be made to the Bank's infrastructure, operating processes and systems;
 - c) Measures to be taken to stop the loss-making activity;
 - d) Measures to restructure competitive business;
 - e) Measures for assets and business lines possible disposal;
8. Within 1 month after submission of the Action Plan, National Bank's supervisory and resolution functions evaluate effectiveness and feasibility of the plan and in case of a positive opinion, notify the bank administrators or the special manager about consent.

9. If submitted action plan does not meet requirements set in relevant regulatory legal acts, National Bank assigns 2 more weeks to eliminate mismatch or discrepancies, during which the timeframe provided for in paragraph 8 of this Article shall be suspended.
10. Due to complexity of the issue, National Bank is authorized to extend deadline of action plan finalization for 1 month, following notification to bank administrators or special manager about the matter.
11. Responsibility for the action plan execution lies upon the bank administrators or appointed special manager. In order to track the process, bank's management submit monitoring report to National Bank, disclosing progress of the action plan, at least once every 6 (six) months.
12. National Bank is authorized to require the bank administrators or special manager to amend the action plan if in the view of National Bank, this is necessary step to meet the objective set in point 1 and 5 of this Article. Such amendments should be agreed with National Bank in accordance with the rules established by this Article.

Article 11. Consequences of bank recapitalization action via bail-in tool

1. Decision of application bail-in tool to recapitalize bank in resolution regime enters into force immediately and execution is mandatory for the Bank, bridge Bank and the shareholders and creditors of the Bank and the Bridge Bank.
2. Bailed-in liabilities or upcoming accruals to bailing liabilities should be canceled without restoration. In case of partial write-down, liabilities remained after bail-in action, stays under existing contractual terms and is subject to amend, if required by National Bank.