

## **Session III.**

# **The basic challenges for DIS in bail-in application. Kazakhstani bail-in experience**

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# DI's main challenges during bail-in resolution



# DI's main challenges during Bail-in resolution

- DI as the major authority, responsible for protecting depositors and being involved in the problem bank resolution process, including bail in, should be an integral part of the financial safety net framework;
- DI should be provided with relevant and timely information on member institutions and especially on seriously troubled banks that could pose a risk of failure and trigger the activation of DIS payouts;
- DI's funds in bank resolution could be used only if DI is a part of decision making process and authorizes the use of its funds;



# DI's main challenges during Bail-in resolution

- DI or any other resolution authority should be equipped with the relevant criteria to use the bail-in tool;
- DI or any other resolution authority should have adequate powers to write down creditors' claims;
- DI as a part of resolution process should be convinced in effectiveness of chosen resolution tool for avoiding double funding costs;
- DI should keep its priority in the claims settlement process to recover its funds in case of ineffective bail in.



# DI's main challenges during Bail- in resolution

- Excessive usage of the bail-in tool in the banking practice results in increased moral hazard for both the bank and the financial regulator.
- Any bail-in calls for accompanying provision of financial support. The question is: who should bare financial burden during the forced bail-in –government or deposit insurer?
- In case of SIFI's bail-in, significant financial funds may be involved. But bail-in may always turn out to be unsuccessful. In this case deposit insurer would have to incur double expenses.



The Kazakhstani economy was also hurt by the impact of global financial crisis.

*Local banks with large international borrowings and significant share of mortgage assets suffered most throughout the banking sector.*

However, from the middle of 2007 and up to now, no banks have been forcibly liquidated in Kazakhstan.

*At the same time **bail-in was conducted in 3 financial institutions, one local SIFI among them.***



# Kazakhstani legal framework for bail-in





# Legal framework as the key attribute of bail-in

Before the beginning of the global financial crisis there were no legislative regulations on bail-in in Kazakhstan. In October 2008 the relevant amendments to the following legal acts were made:

**Law On Banks and Banking Activity** determines among other provisions:

- ✓ the grounds for the bail-in's implementation
- ✓ the decision-making authorities
- ✓ procedures for conducting forced or voluntary bail-in
- ✓ NCWO rules
- ✓ conditions for selling State share in bank's equity, etc.

**Law on Sovereign Wealth Fund**

- ✓ granted Samruk-Kazyna the power to buy out the additionally issued shares to dilute the original share of holders and thereby to provide the financial assistance to the rescued banks

**Law on Joint Stock Companies**

- ✓ defined the priority rights of shareholders to purchase the additionally issued shares;

**Law on State Property**

- ✓ defined the State responsible body's rights to purchase the additionally issued shares;

**Standalone decrees** of the Kazakhstani Government on purchasing shares from the second-tier bank(s),

**The Rules of the Financial Supervision Agency** for the Forced Buyout of the Bank's Shares and their Mandatory Sale to the Investors.

## **2 COMPLEX CASES:**

Despite quite comfortable conditions of liabilities restructuring (i.e. extended terms to maturity, and grace period for repayment),

- BTA Bank had to pass through two bail-ins: the first in 2009 (on forced basis), and the second - in early 2012 (on voluntary basis)
- Alliance Bank underwent bail-in in 2010 (on voluntary basis) without improvements in capital and assets quality

## **AS WELL AS SUCCESSFUL ONE :**

The Temirbank passed through bail-in in 2009 on voluntary basis with positive results



# **SIFI Bail-in experience in Kazakhstan**



# BTA Bank – a local bank with International businesses

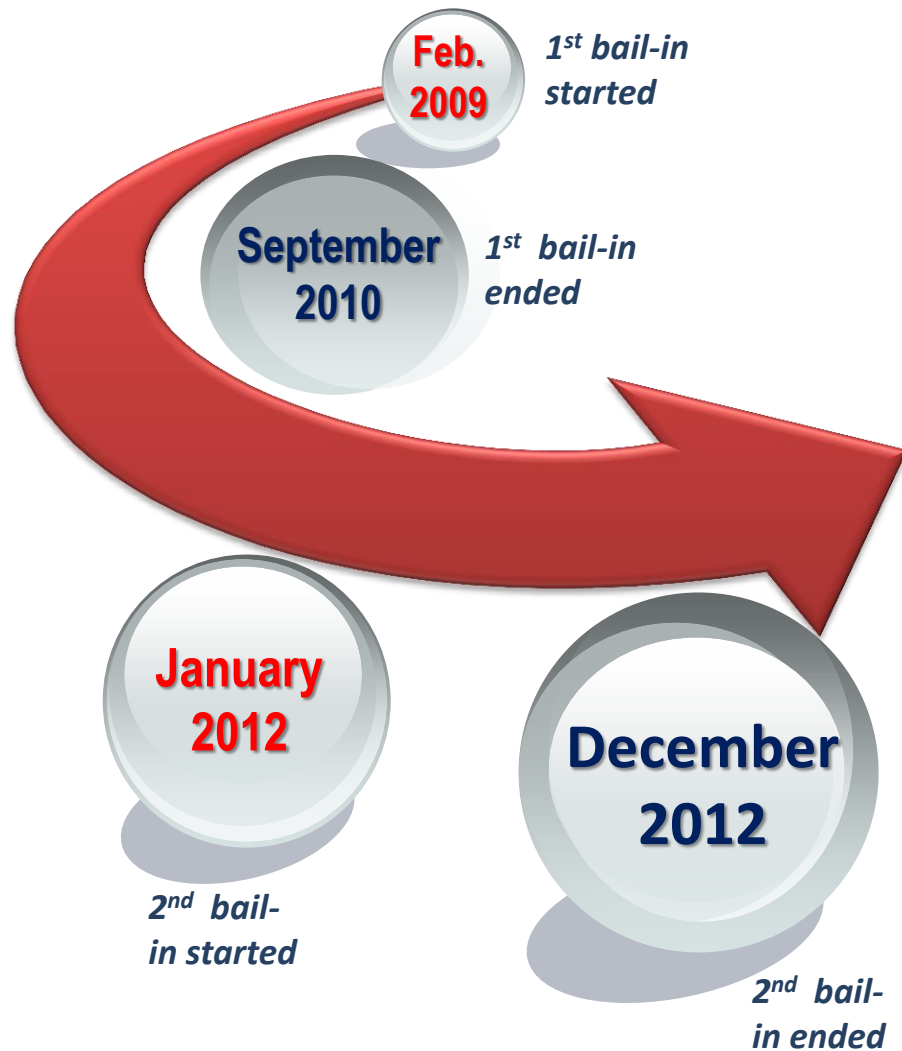
*BTA was a large Kazakhstani bank with high exposures and major shares in primary segments:*

	Market share - 01 Feb., 2009	Market share – 01 May, 2012
Assets (consolidated)	24%	11%
Loans (industry and retail)	23%	21%
Retail deposits	18%	8%
Capital	29%	-45%
Capital (in peer group of other SIFIs)	38%	-233%

*BTA Bank holds foreign subsidiaries in Russia, Belarus, Kyrgyzstan and non-controlling stakes in financial institutions in Ukraine, Georgia, Armenia, Russia and Turkey. SPV-s are established in Netherlands and Luxembourg*



# BTA Bank – the timeline



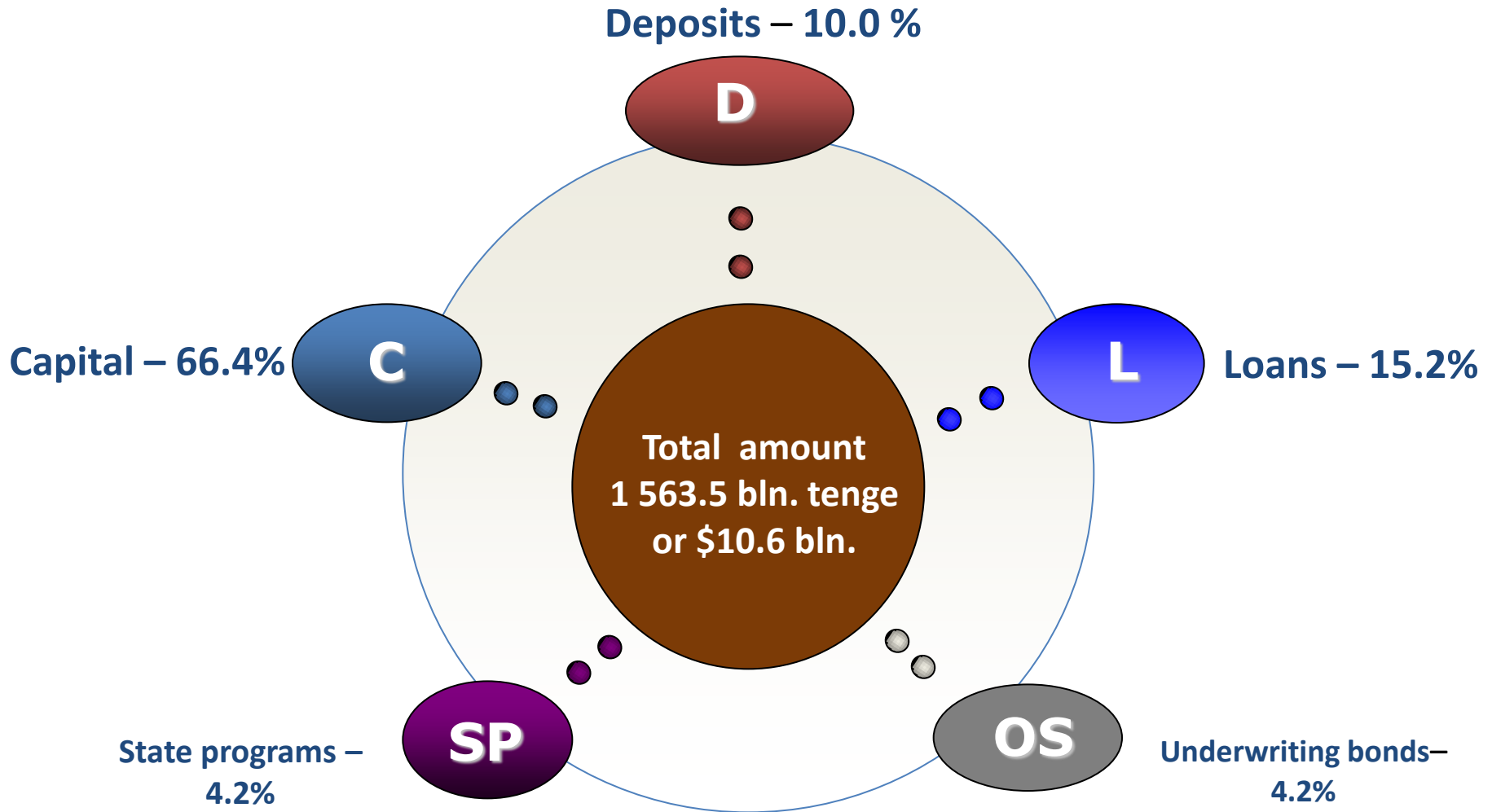
*In 2008, significant deterioration in financial position of BTA Bank and subsidiaries was observed. Capital deficit reached 1,689 billion tenge (\$ 11.3 bln.)*

- **02 Feb 2009** Government issued a directive requesting a mandatory increase in BTA capital,
- **03 Feb 2009** Sovereign Wealth Fund JSC Samruk-Kazyna acquired 75% stake in capital for 212 billion tenge (\$1.43 bln., 7% of total assets),
- **16 Feb 2009** Changes in management board,
- **March 2009** SWF JSC Samruk Kazyna acquired bonds at par value 645 billion tenge (\$4.34 bln., 27% of liabilities), provided 62 billion tenge (\$0.4 bln.) in financial assistance,
- **Oct 2009** bail-in was approved by the court,
- **May 2010** the restructuring plan was approved by creditors,
- **Sept 2010** bail-in was implemented, the new entitlements were settled among the parties.

*First bail-in didn't meet regulators expectations as capital deficit at the end of 2011 composed 534.8 bln. tenge (\$3.59 bln.)*

- **7 Jan 2012** BTA Bank defaulted on coupon payments on local bonds,
- **Apr 2012** - Changes in management board,
- **March 2012** Restructuring of liabilities was requested by the Board of Directors,
- **May 2012** the request was approved by the court,
- **Dec 2012** the restructuring plan was approved by creditors,
- **Dec 2012** the restructuring plan was implemented, and new entitlements were settled among parties.

# Total State financial support



# The results of the 1<sup>st</sup> Bail-in

	Prior – EOY 2008 (audited)		Post-BI – EOY 2010 (audited)		Change
	<i>bln. tenge</i>	<i>bln. USD</i>	<i>bln. tenge</i>	<i>bln. USD</i>	
Assets	2,194	18.2	1,896	12.9	– 14%
Liabilities	2,936	24.3	2,000	13.5	– 32%
Capital	– 743	-6.2	– 104.5	0.7	+ 86%

- ✓ **Total bail-in made up 1,7 bln. tenge (\$ 11.6 bln.), and mostly affected foreign creditors (incl. bondholders), and to a lesser extent – local creditors. The bank cancelled previously issued bonds and other liabilities and in return paid out \$945 mln. to its creditors in cash, and also issued new debt securities (incl. recovery notes) in the total amount of \$9.8 bln.**
- ✓ **Bank's liabilities fell almost 1.5 times, while the repayment period increased from 8 to 20 years. Capitalization was raised 1.86 times;**
- ✓ **The total write off made up about 45% (instead of anticipated 60%) from the total bailed in amount.**
- ✓ **Creditors received 18.5% of the bank's ordinary shares and positions in the bank's Board of Directors;**
- ✓ **By the end of the first bail-in the state owned 81.5% of the bank's ordinary shares.**



The 1st BTA Bank's bail-in did not live up to all expectations.

Government as the major shareholder of the bank had to step in the bail-in process as creditor's counterpart, and could not convince the creditors to accept the haircuts at the offered level.

The creditors strongly believed that Government should assume its responsibility as a main owner of the bank and extend additional financial assistance to BTA. Meanwhile, the creditors' interests were not compromised to a large extent during the bail-in, and the restructured creditors were entitled membership in creditors' committee.

So, the 1<sup>st</sup> resolution measures did not allow to absorb the bank's losses and restore its capital to the adequate level. The situation was aggravated by continuous economic downturn, which deprived BTA of opportunity to raise returns on its assets, improve their quality, and restore the financial position.





***LESSON 1. DUE DILIGENCE SHOULD BE CONDUCTED BEFORE SELECTING A RESOLUTION TOOL***

***LESSON 2. THE STATE SHOULD NOT ASSUME THE LIABILITIES OF PRIVATE BUSINESS PRIOR TO CONDUCTING BAIL-IN, IF THE LATTER WAS CHOSEN AS A RESOLUTION TOOL***



Later on, in early 2012, BTA Bank's shareholders equity dropped to negative level, and the bank recognized net losses at 418 billion tenge (\$2.8 bln.).

The decision on the necessity to conduct the 2<sup>nd</sup> bail-in was made by the bank's management on voluntary basis. This decision became a viable alternative to forced liquidation of the bank. The initiative was supported by the authorities later on.

However, the creditors did not support the idea of the 2<sup>nd</sup> bail-in. The key argument of BTA in favor of its 2<sup>nd</sup> bail-in was impedance of bank liquidation due to deterioration of its financial standing.

Taking into account the historically bad quality of assets of the bank, and the entitlement to 6<sup>th</sup> & 8<sup>th</sup> sequences of creditors' claims, the probability of reimbursement was quite low.

In May 2012, the Board of Directors applied for the 2<sup>nd</sup> bail-in, which was much tougher for the creditors, with write-downs of liabilities and large values converted to equity.

The State had to bail-out the bank in the amount of KZT 415 bln. (\$2.8 bln.), as the latter was one of the covenants for write-downs of certain liabilities. 56.9% of this amount comprised a loan extended by SWF Samruk-Kazyna as pledge for repayment to creditors and the rest of the amount was converted into the common equity.



# BTA Bank: the 2<sup>nd</sup> Bail-in and Bail-out

- ✓ The total bail-out comprised 416.3 bln. tenge (\$2.8 bln.) :
  - **56.9%** - *Loan extended by SWF Samruk-Kazyna as pledge for repayment to creditors*
  - **0.8%** - *Increase in capital via conversion of subordinated bonds into common equity. Stake of SWF Samruk Kazyna in capital reached 97.28%*
  - **42.3%** - *Deposits of SWF Samruk-Kazyna converted into common equity*
- ✓ Total bail-in comprised 1,685 bln. tenge (\$11.2 bln.) mainly by cancelling recovery units and previously issued bonds and delivering cash and newly issued bonds; converting deposits of SWF Samruk-Kazyna and subordinated debts into common equity.
- ✓ The total write off made up about 55%.
- ✓ The State share in the bank's capital reached 97.2%



## The 2<sup>nd</sup> Bail-in results

	BOY 2009 (audited)		EOY 2013 (audited)		Change
	<i>bln. tenge</i>	<i>bln. USD</i>	<i>bln. tenge</i>	<i>bln. USD</i>	
Assets	2,194	18.2	1,602	10.4	-27%
Liabilities	2,936	24.3	1,322	8.6	-55%
Capital	- 743	-6.2	280	1.8	+138%

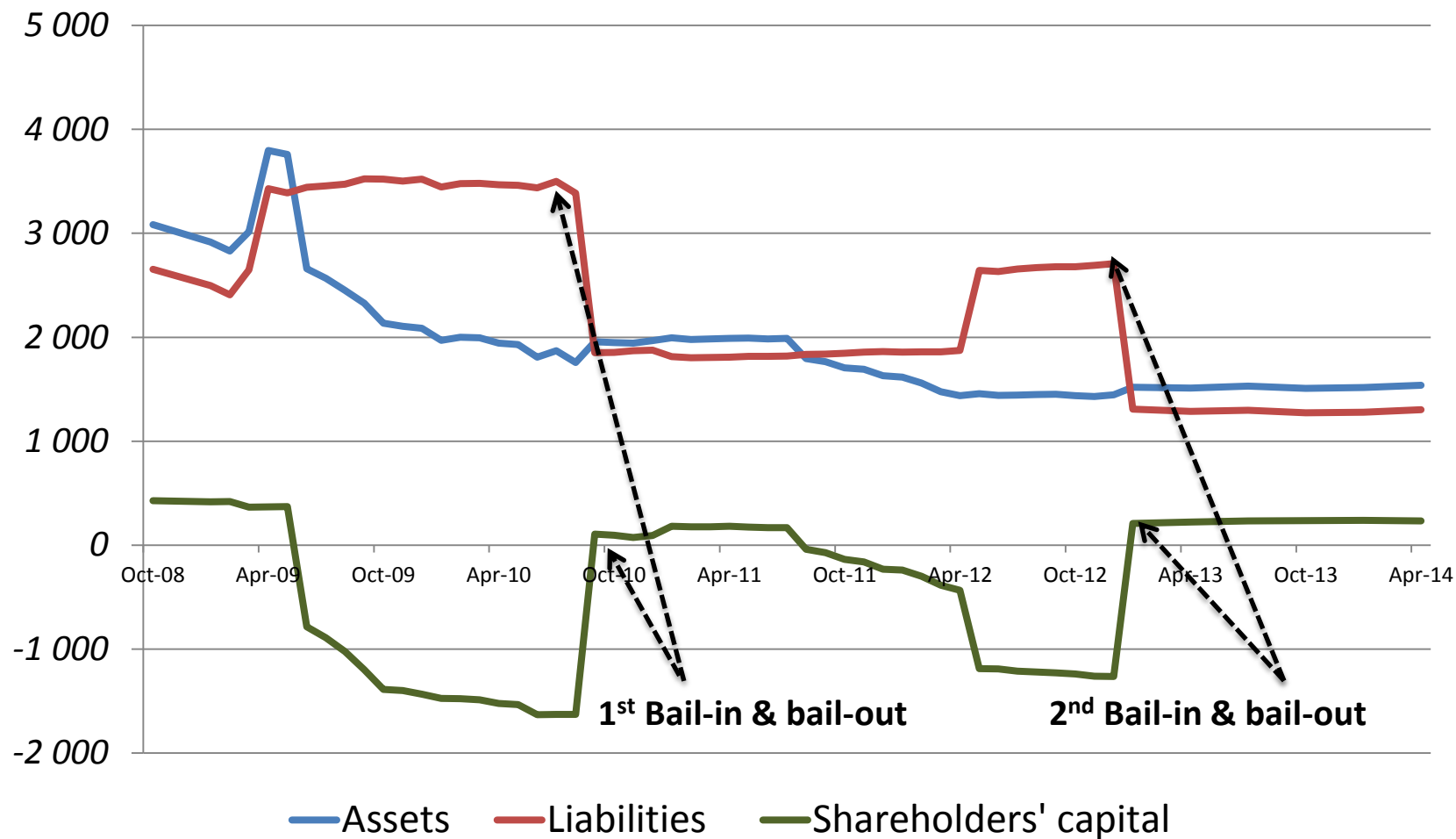
Two local investors: one LSIFI and one individual - agreed with the ultimate conditions for acquisition of 46.5% stake in capital (each party) of BTA Bank from SWF Samruk-Kazyna. The price for a 46.5% stake in BTA Bank's capital was more than 72 bln. tenge (\$390 mln.). 31 bln. tenge (\$17 mln.) was paid on settlement date, and 41 bln. tenge (\$22 mln.) must be paid by 01 July, 2017, at the latest.

SWF Samruk-Kazyna will retain the stake in the capital of BTA Bank.



# Dynamics of financial position – BTA Bank

(in billions tenge)



Thus the cumulative reduction in liabilities after two bail-in processes attained 60%. Despite the quite high level of liabilities' write offs, it is too early to recognize final restoration of bank's financial standing. As our experience reveals, effectiveness of bail-in as a resolution tool depends to high extent on bank's operating environment and corporate governance quality.

***Lesson 3. Bail-in should be conducted by highly qualified crisis managers whose resolution strategy comes from extensive analysis of environment and bank's strengths and weaknesses.***

***Lesson 4. The bank management should clearly recognize the amount of liabilities to be written off sufficient to restore the capital to the minimum required level. Otherwise additional resolution tools should be employed.***



**Lesson 5.** *A higher level in write-downs of liabilities based on the No Creditor Worse Off rule should be established, which enables recovery of a problem financial institution. In case of exceeding these limits, the regulator should be ready to conduct forced liquidation of a SIFI, or to have the other resolution tools in place*

**Lesson 6.** *The State or DI should clearly determine for themselves and inform the public about the extent of their financing the bank recovery process*



**Does Bail-in work with  
medium-sized financial institutions?  
- The Temir bank case**





# The case of Temir bank

- ✓ The Temir bank was a medium sized bank representing 4% in the overall market share in terms of capital
- ✓ Temir bank was the subsidiary of the BTA, whose default has seriously undermined its financial stability ;
- ✓ The completion of bail-in on the Regulator's terms was put forward by the State as a precondition for bail-out;
- ✓ The bank's previous top management was discharged;
- ✓ Bail-in process lasted from October 2009 to June 2010;
- ✓ Bank's liabilities decreased from 277 bln. tenge (\$1.9 bln.) to 181 bln. tenge (\$1.2 bln.);
- ✓ Thus, aggregate losses of the bank's creditors composed \$0.8 bln., or 41%;
- ✓ The bank's authorized capital increased by 25 bln. tenge (\$168 mln.);
- ✓ Subsequently the State entered the bank's capital and its share attained 80%.



# Temir bank- the timeline



**14 Oct 2009**, BTA Bank and SWF Samruk-Kazyna signed agreement on delivery of 13 mln. of Temir bank' ordinary shares under trust agreement to JSC Samruk-Kazyna

**By 31 Dec 2009**, Temir bank violated capital and liquidity prudential requirements.

**Nov 2009** Temirbank was assigned "C" rating by Moody's, Fitch and S&P

**18 Nov 2009** FSA and SWF Samruk-Kazyna entered into restructuring agreement

**23 Nov 2009** Court approved restructuring process

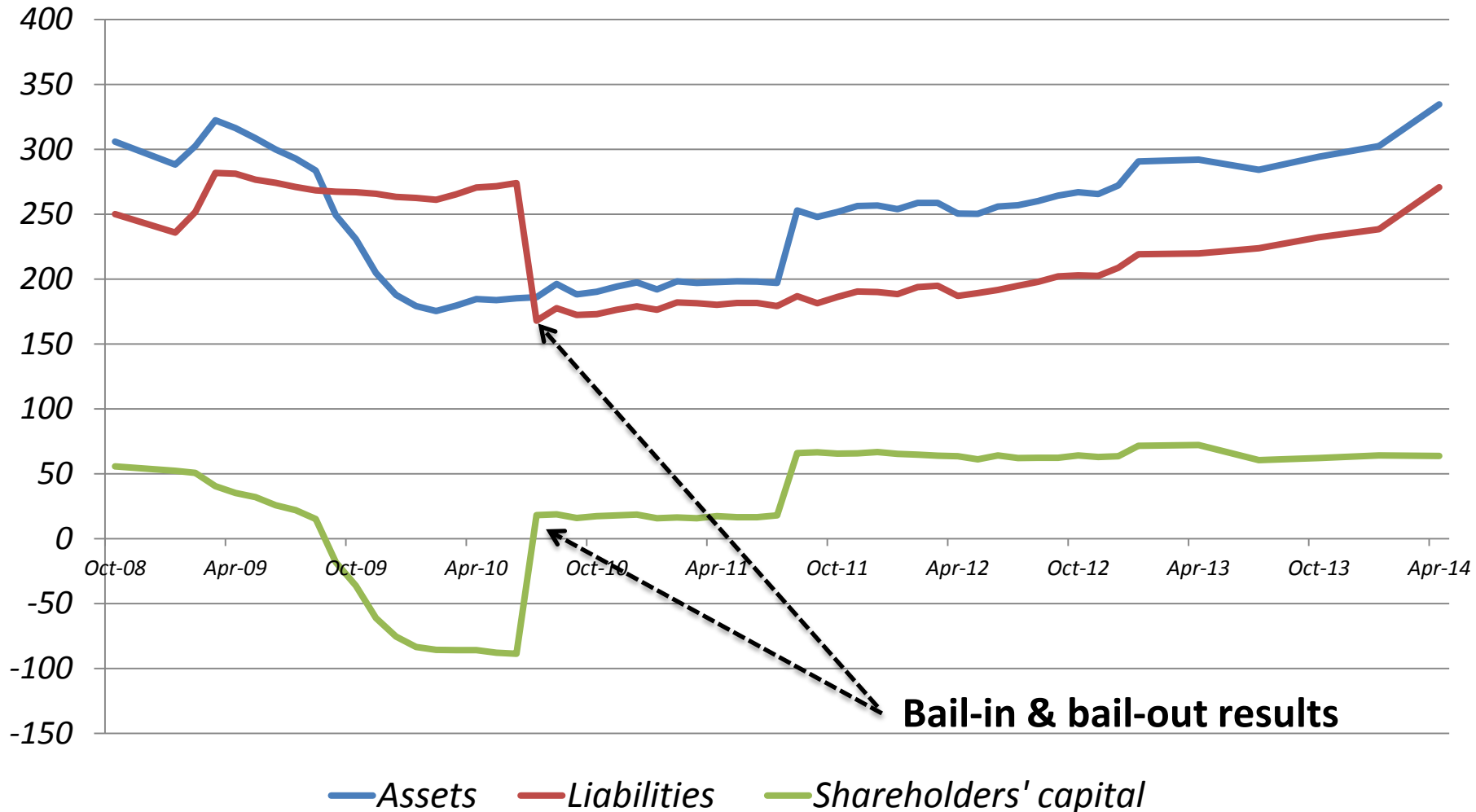
**18 Dec 2009** Temir bank approved the key preliminary covenants with creditors

**29 Dec 2009** FSA established the deadline for obtaining the creditors approval of haircut of their claims at required level by 31 March 2010

**31 March 2010** Creditors approved the Restructuring and Recapitalization Plan

**By 30 June 2010** the restructuring plan was implemented and Temir bank was in compliance with all capital adequacy and liquidity ratios

# Dynamics of financial position – Temir bank (in billions tenge)



## Temir bank: bail-out and bail-in

- ✓ The total bail out comprised 88.5 bln. tenge (\$ 584,5 mln.):
  - **34%** – State support programs by SWF Samruk-Kazyna
  - **66%** – additional capitalization by SWF Samruk-Kazyna
- ✓ Total bail-in comprised 216.3 bln. tenge (\$1.5 bln.) as a result of bail-in, total liabilities of the bank were cut from 277 bln. tenge (\$1.9 bln.) to 181 bln. tenge (\$1.2 bln.) or by 41%.
- ✓ In line, terms were extended from 1 – 4 years to 10 – 12 years. 19.3% newly issued common shares were delivered to external creditors. 80% was held by SWF Samruk-Kazyna. As soon as in February 2011, Temir bank paid back 45% deposits placed by SWF Samruk-Kazyna.
- ✓ On May 15, 2014 the local investor acquired 80 % of the State' share in the bank



**Lesson 7.** *Successful bail-in experience of JSC Temir bank demonstrates potential opportunities for applying this tool to small- and medium-sized banks.*

*However, bail-in of such banks could have more serious implications than visually positive results.*

*The failure of such a bank will not have the same financial and social implications as failure of SIFI, therefore the troubles in a certain small bank do not determine the bail-in as an efficient resolution tool.*

*Again, the haircut of claims would infringe on the creditors' interests, which damages the reputation of the bailed-in bank, and consequently deteriorates the country's investment climate.*



***Thank you for your attention!***