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The European Commission wants to give regulators the power to convert debt issued by ailing banks into equity as they try to avert the collapse of failing institutions without leaning on taxpayers. In the latest in a long line of far-reaching reform proposals from internal markets commissioner Michel Barnier, the EU executive also wants to give regulators the power to depose the management of vulnerable institutions, suspend dividend payments, force asset sales and compel an institution to implement a recovery programme.

Mr Barnier?s plan, which also foresees powers to install a special management team in distressed banks, is designed to prevent a repeat of costly episodes such as the Irish banking crisis by introducing new resolution procedures to facilitate an ?orderly? wind-down of institutions that have no prospect of survival. In anticipation of legislative proposals next year, he set out his thinking yesterday in a communiqué on ?crisis management? in the financial sector. While some of the measures he proposes have already been deployed by EU governments on an ad hoc basis ? Ireland among them ? the commissioner wants to have common rules throughout Europe for phased resolution procedures.

Possible measures at the end of such a phased process include a ?debt write-down tool?, a procedure to restore an institution?s capital position by writing off all its existing equity and converting its debt to equity or writing down some of its debt. While the Government wants second-tier holders of debt in Anglo Irish Bank to take a haircut on their liabilities, it insists senior debt holders will not have to take write-downs for fear of undermining confidence in Ireland among bank investors who also buy Irish sovereign debt.

Mr Barnier?s paper points to ?significant legal and policy questions? over debt writedown and equity conversion measures. Among them is the question of whether the public authorities should have statutory powers to writedown debt and whether such writedowns would have an impact on the cost of funding. ?In spite of the technical challenges presented by the design of a debt writedown mechanism, the commission considers that it offers an additional resolution tool that would significantly enhance the ability of the authorities to resolve large, complex financial institutions,? the paper said.

Other resolution options include the forced sale of business units without the consent of shareholders and the transfer of some or all of an institution?s operations to a temporary bridge bank. Further options include the removal of toxic assets to a separate vehicle, a procedure similar to the transfer of Irish property and development loans to Nama. Institutions would be obliged to prepare in advance of any crisis a recovery plan setting out measures it would take to deal with funding problems in a range of stress scenarios.

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