Bail-in triggered **Balance sheet** No bail-in triggered (down-and-out call option) (down-and-in call option) Preferred Value of preferred creditors Value of preferred creditors credit \$40 Senior debt Asset \$100 40 40 \$53 Equity \$7 40 Value of assets Value of assets Value of senior debt Value of senior debt **Balance sheet identity** Value of total liability 53 (debt+equity) 100 Value of assets Value of assets Value of equity Value of equity

Figure 3.22. Pricing of Liabilities under Bail-in Power

Source: IMF staff.

100 Value of assets

Note: X and Y depend on the extent of dilution for existing shareholders when bail-in power is applied. In this exercise, senior debt holders and existing shareholders are assumed to receive new equity in proportion to the market value of their respective claims. Suppose $SenD^*$ and E^* represent the market value of senior debt and equity, respectively, when bail-in kicks in. Senior debt holders receive $SenD^*/(SenD^*+E^*)$ percent of new equity and the rest goes to existing shareholders. The balance sheet identity implies that the total value of assets should be equal to the total value of liabilities, which is the sum of the values of preferred credit, senior debt, subordinated debt, and equity.

93 100 Value of assets

Value of assets