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Key Legal Aspects of Bank Resolution
Danish experiences

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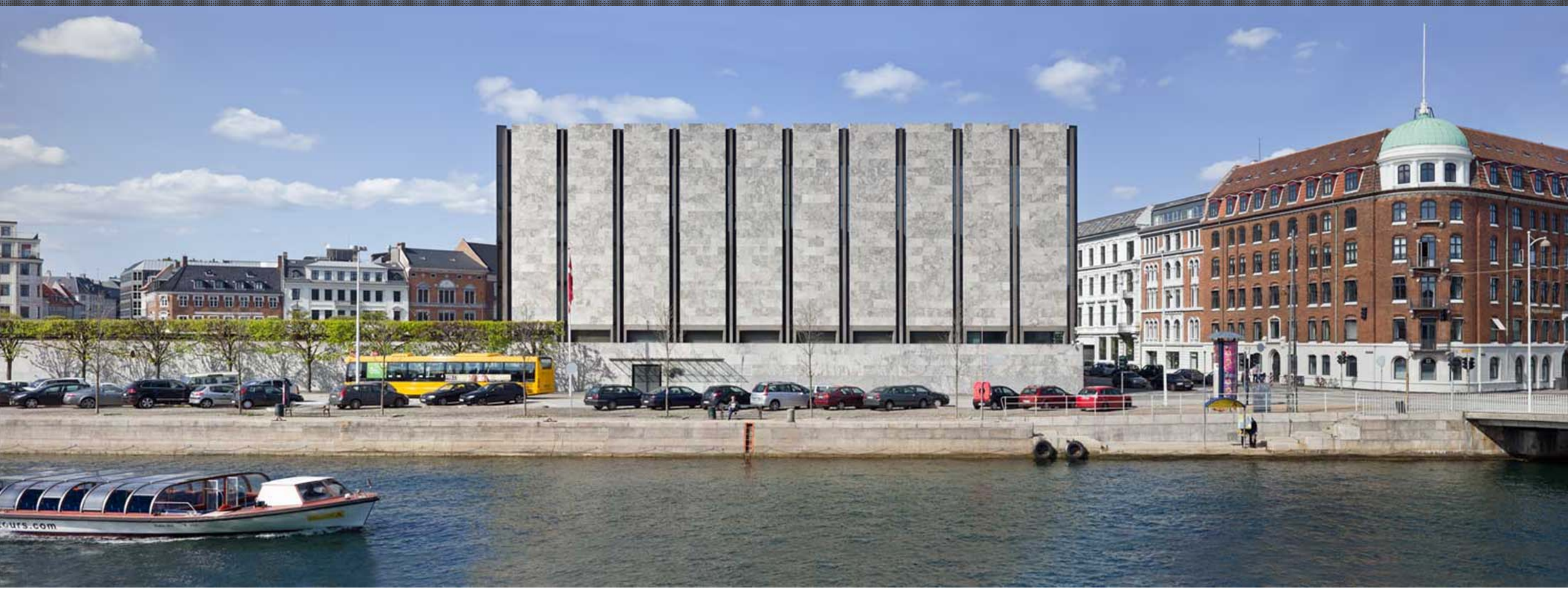

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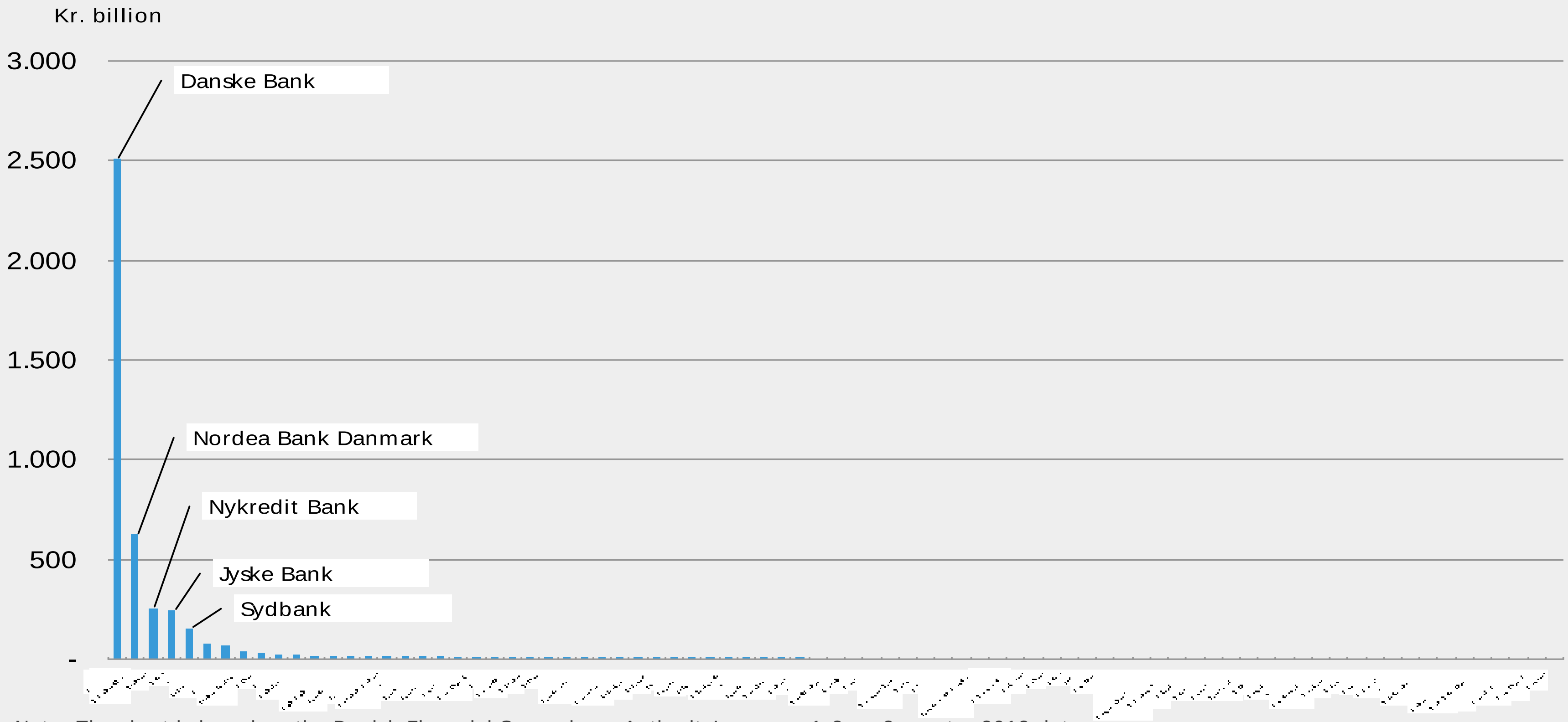
Heterogeneous banking sector

Assets in Danish banks



Note: The chart is based on the Danish Financial Supervisory Authority's groups 1-3 on 3 quarter 2012 data.
Kilde: Danish Financial Supervisory Authority and own calculations.

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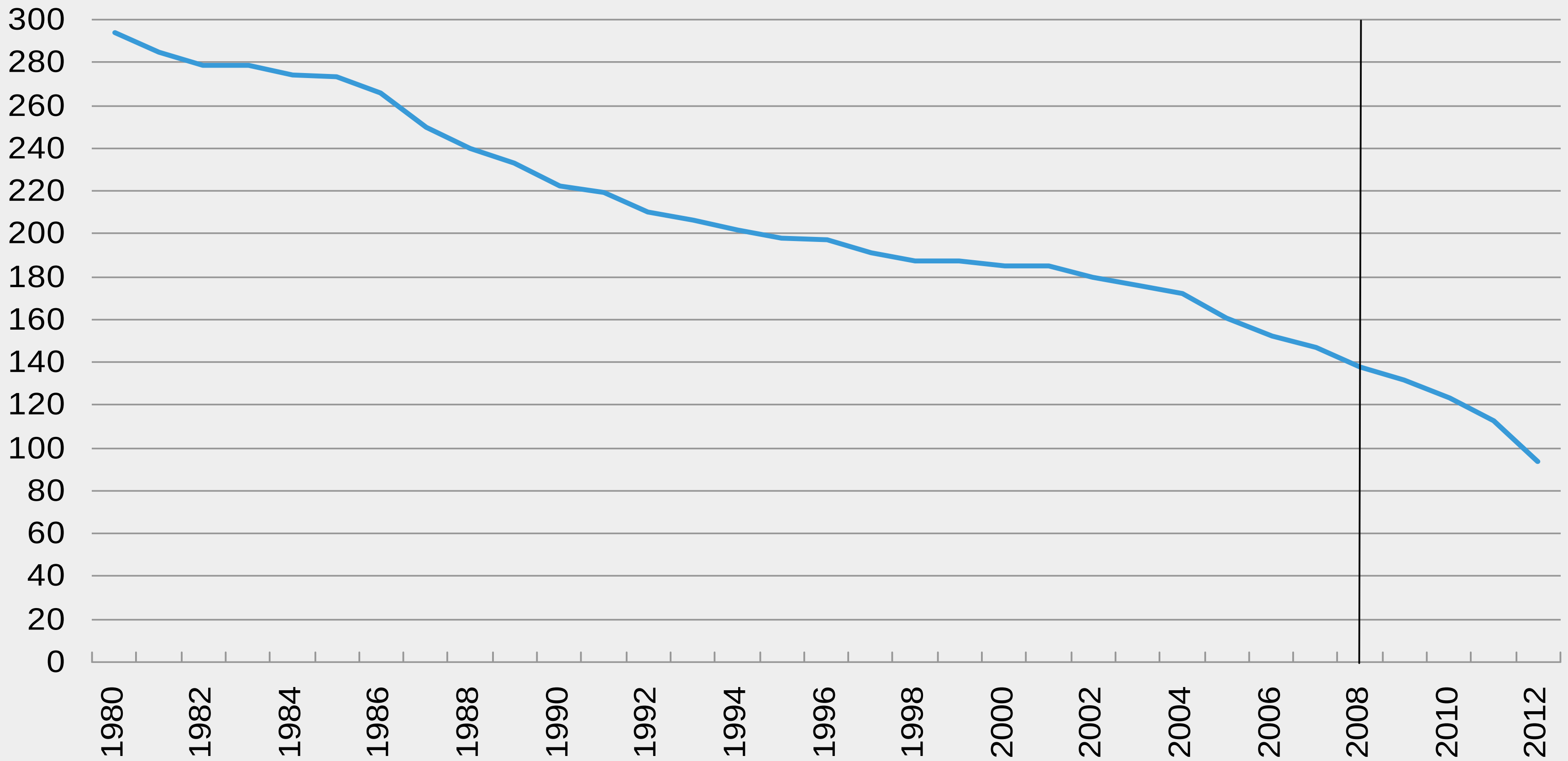
Number of banks in Denmark



Note: The chart is based on the Danish Financial Supervisory Authority's groups 1-4 at the end of 2012.
Source: Danish Financial Supervisory Authority and own calculations.

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The Danish Resolution Scheme - Background

- No resolution mechanism for winding up banks before crisis
- Danmarks Nationalbank took over Roskilde Bank, August 2008
- General Government Guarantee, October 2008 - October 2010 (”Bank Package 1”)
- Resolution scheme for winding up banks, October 2010 (”Bank Package 3”)
- Amendment to facilitate private sector solutions, August 2011 (”Bank Package 4”)

Background (2)

- Shareholders and holders of subordinated capital lost everything in:
  - Roskilde Bank
  - All 7 banks that failed during the General Government Guarantee (I)
  - Amagerbanken and Fjordbank Mors that failed under original resolution scheme (III)
  - All 4 banks that have failed until now during the amended resolution scheme (IV)

- No direct government costs of interventions since 2008. All costs paid by the financial sector
  - Shared payment of guarantee commissions (to the state and to the Depositors' Guarantee Fund)

Premisses for a new resolution scheme (spring 2010)

- Without a resolution scheme, the General Government Guarantee would implicitly continue
  - The need to place responsibility
  - Avoid moral hazard – and state aid rules
  - No tax payer money at risk – losses to be paid by market participants
- Accept losses – even for depositors and ordinary creditors
  - Deposit Guarantee Directive – 100,000 euro
- Experience from winding up of banks during the General Government Guarantee (the Financial Stability Company)
  - A need for a formal resolution tool (crisis or not)

Premisses for a new resolution scheme (2)

- Controlled winding-up via the state-owned winding-up company – the Financial Stability Company
  - In order to avoid adverse effects of bankruptcy law:
    - Credit cards/webbank useless
    - Forced sale of assets
- The competent body of the bank has to make the decision (resolution on voluntary basis)
- In accordance with Danish legislation on bankruptcy

Danish Resolution Scheme (Bank Package 3)

- The resolution regime can be used if
  - a bank no longer meets the regulatory capital requirements,
  - the DFSA has set a deadline for the bank's restoration of the capital, and
  - the board of directors decides (within 6 hours) that the bank is to be wound up under the resolution scheme, if the capital cannot be reestablished before the deadline
    - Specific provision in the Financial Business Act: The board of directors is competent to make this decision without the prior consent of the general assembly (the shareholders) – unless the general assembly has decided beforehand that the resolution scheme is to be used in such a situation
    - Briefing of the general assembly within 8 days

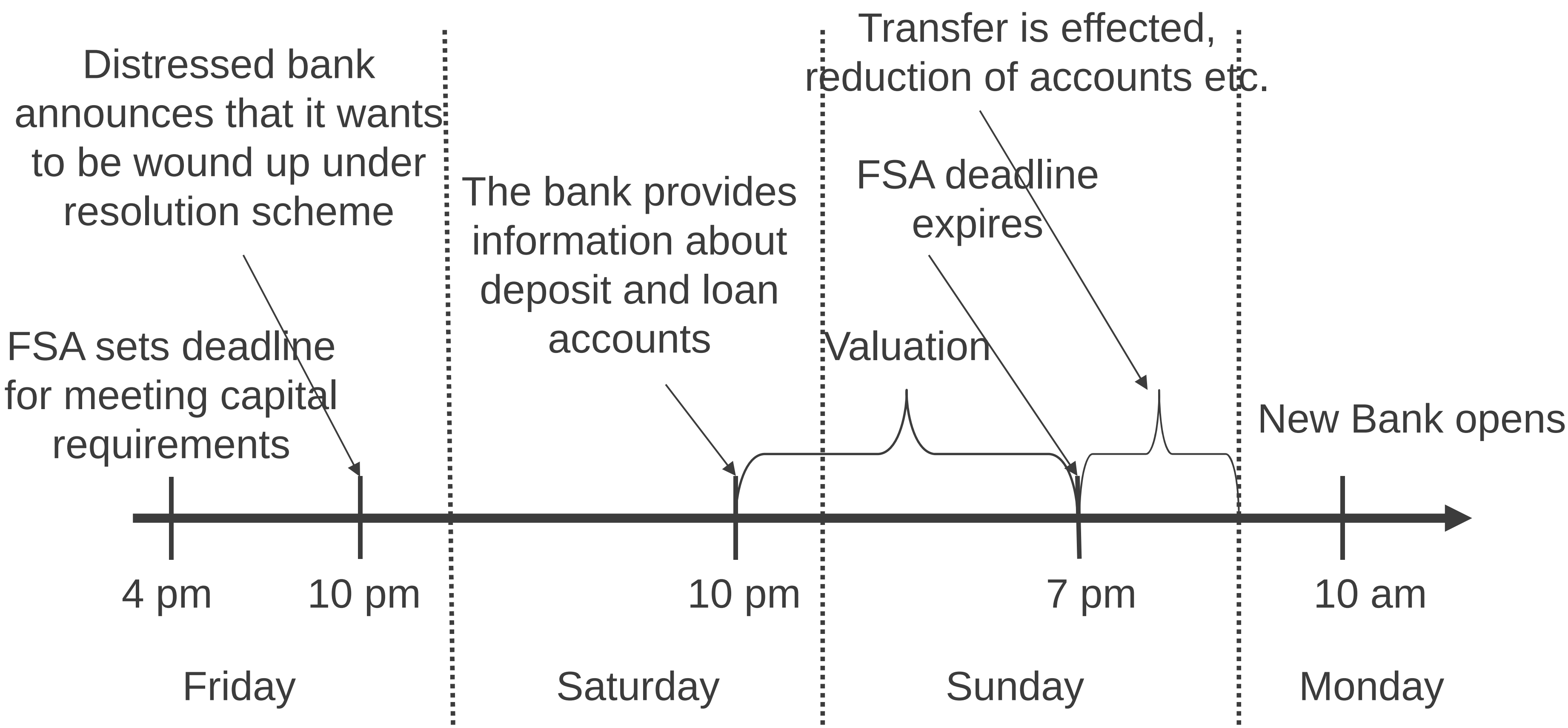
Danish Resolution Scheme (2)

- Assets of the distressed bank are transferred to a subsidiary bank of the Financial Stability Company (New Bank)
  - The transaction is concluded during a weekend – reduces the risk of a run on the bank
  - The Financial Stability Company injects capital and liquidity into New Bank on Sunday
  - New Bank opens Monday morning as a fully licensed bank
- New Bank purchases the assets after a haircut and funds the transaction by taking over non-subordinated liabilities of the same amount
- Share capital and other subordinated capital will not be transferred (i.e. lost)

Danish Resolution Scheme (3)

- Non-subordinated liabilities will only be partially transferred. Creditors must anticipate immediate losses.
  - Depositors are insured up to 100,000 euro
- Customers’ engagements are carried on uninterruptedly in New Bank (apart from non-covered claims)
- New Bank activities sold or continued/phased out
  - Profit in New Bank paid to insolvency estate of Old Bank
  - Loss in New Bank guaranteed by the Depositors’ Guarantee Fund (the Fund’s Winding Up Division)
- The remaining part of Old Bank is wound up according to normal insolvency procedures

Timeline for transfer



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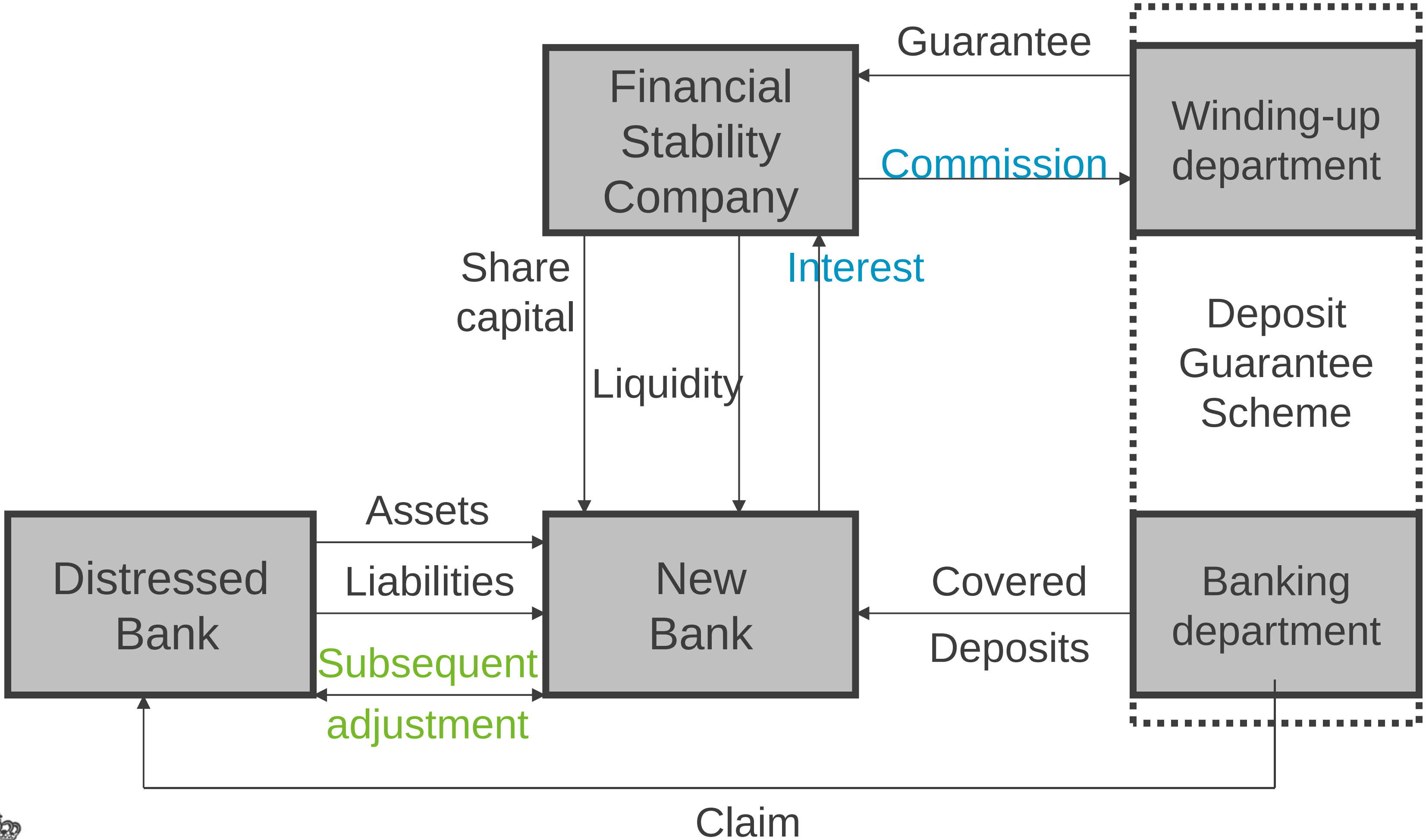
Transactions during the winding-up process



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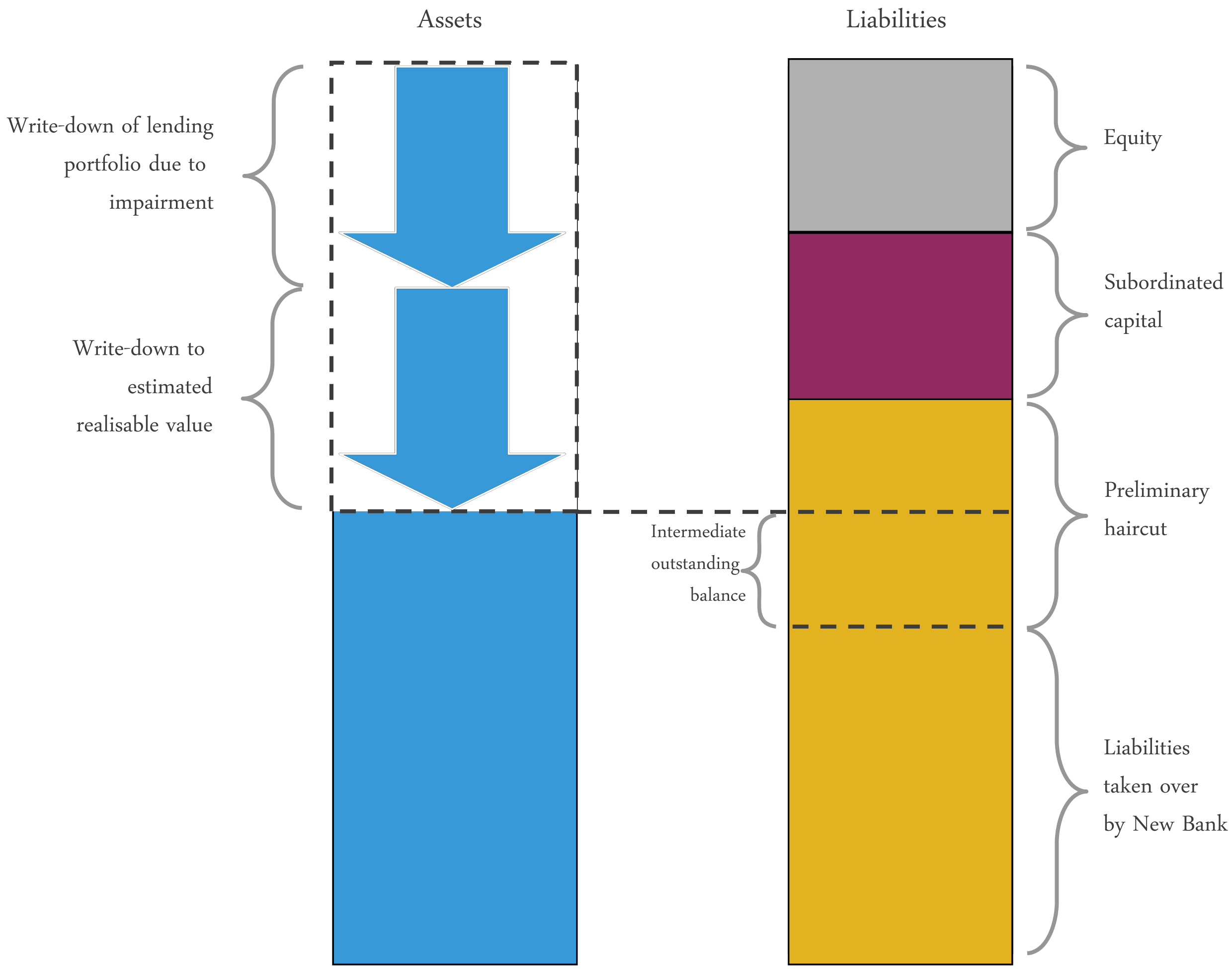
Assets and liabilities of bank in distress



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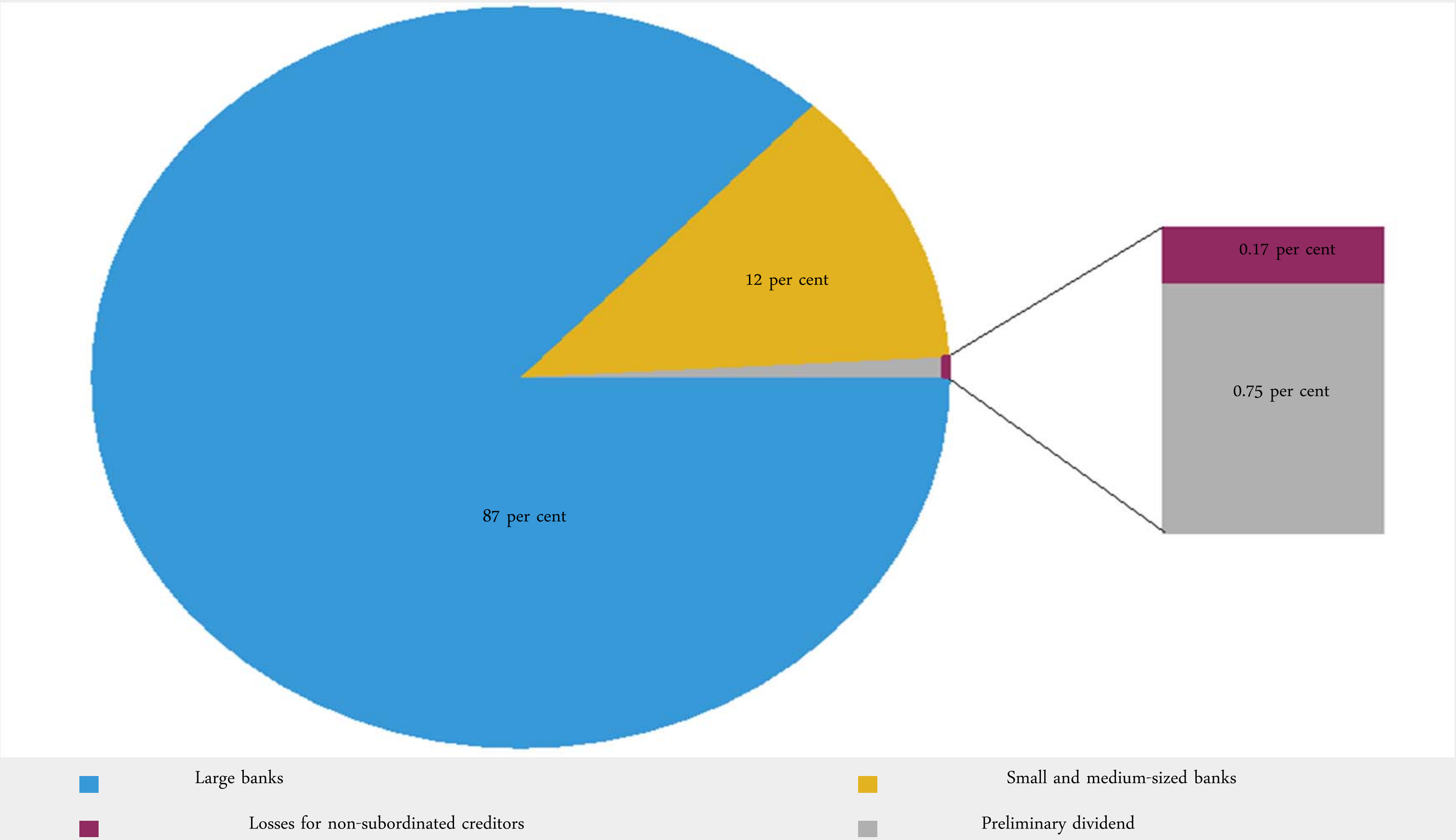
Two banks have been wound up according to the new resolution scheme (Bank Package 3)

- Amagerbanken A/S (February 2011)
  - Traditional retail bank based in Copenhagen with market share around 1 per cent
  - Heavy credit growth since 2005, especially in commercial property
  - Initial haircut of 41%; semi-final haircut of 15%

- Fjordbank Mors A/S (June 2011)
  - Local retail bank with market share around 0.5%
  - Deterioration in large exposures towards the real estate sector and the agricultural sector
  - Initial haircut of 26%; semi-final haircut of 14%

Losses on non-subordinated debt in Amagerbanken and Fjordbank Mors

Non-subordinated liabilities in Danish banks, end-2012



Danish experiences

- It is possible to handle a distressed small or medium sized Danish bank over a weekend so that the bank activity can be continued Monday morning with full service
- Credible resolution mechanism is facilitating private sector solutions
- Funding costs may have risen for Danish banks
- No bank runs during financial crisis despite of closure of 14 banks
- Danish depositors are very conscious of the Depositors' Guarantee Fund coverage

Consolidation Package (Bank Package 4)

- Facilitates sale of distressed bank (same situation as under Bank Package 3)
  - Model 1: Sale of the whole bank
  - Model 2: Bank is split into a bad and good part (Red Bank/Green Bank)
    - Red Bank = New subsidiary of the Financial Stability Company (New Bank) – controlled winding-up
    - Green Bank is transferred to a sound bank against payment of agreed purchase price – will as a minimum comprise all engagements with private customers

- Valuation of assets/liabilities as under the resolution scheme

- Payment (”dowry”) from Depositors’ Guarantee Fund up to an amount equal to the expected loss if the bank were to be wound up under the resolution scheme

Bank Package 4 (2)

- Payment (”dowry”) from the Financial Stability Company up to an amount equal to the state’s expected loss on individual state guarantees if the bank were to be wound up under the resolution scheme – payment is subject to an earn-out regulation

- The ”dowry” models presuppose complete transfer of the distressed bank’s non-subordinated debt to another bank which is capable of continuing all activities under a viable business model (a sound bank):
  - All non-subordinated creditors, including depositors, will not suffer loss
  - Share capital and subordinated capital are not covered

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SIFI's in Denmark (Bank Package 6)

Political agreement, October 10, 2013 (legislation not yet passed in Parliament)

3 main elements:

1) Special requirements for Danish SIFIs are introduced – must be better capitalised than other institutions

2) Requirements in general for Danish banks and mortgage-credit institutions will be tightened (i.a. stricter requirements to the institutions' capital and liquidity)

3) A governing board in the Danish FSA will be established – strengthening i.a. the management of the organization of supervisory activities