The German Bank Restructuring Act

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German Bank Restructuring Act

- Bank Restructuring Act proclaimed on 14 Dec 2010, entered into force on 1 Jan 2011
  - Germany established the first comprehensive and ready-for-operation framework for crisis management in the banking sector
    - At the time of proclamation, cutting-edge in Europe
    - Speedier steps than on both the European level and in some other European countries
    - Several EU Member States have adopted the German approach
- Funding by periodic contributions and – if needed – special contributions levied on the financial sector
    - Financial sector contributions to replace taxpayers involvement

German Bank Restructuring Act: Involved authorities

- Deutsche Bundesbank in ongoing banking supervision.

- Federal Supervisory Authority (BAFin) in taking supervisory measures vis-à-vis supervised financial institutions.

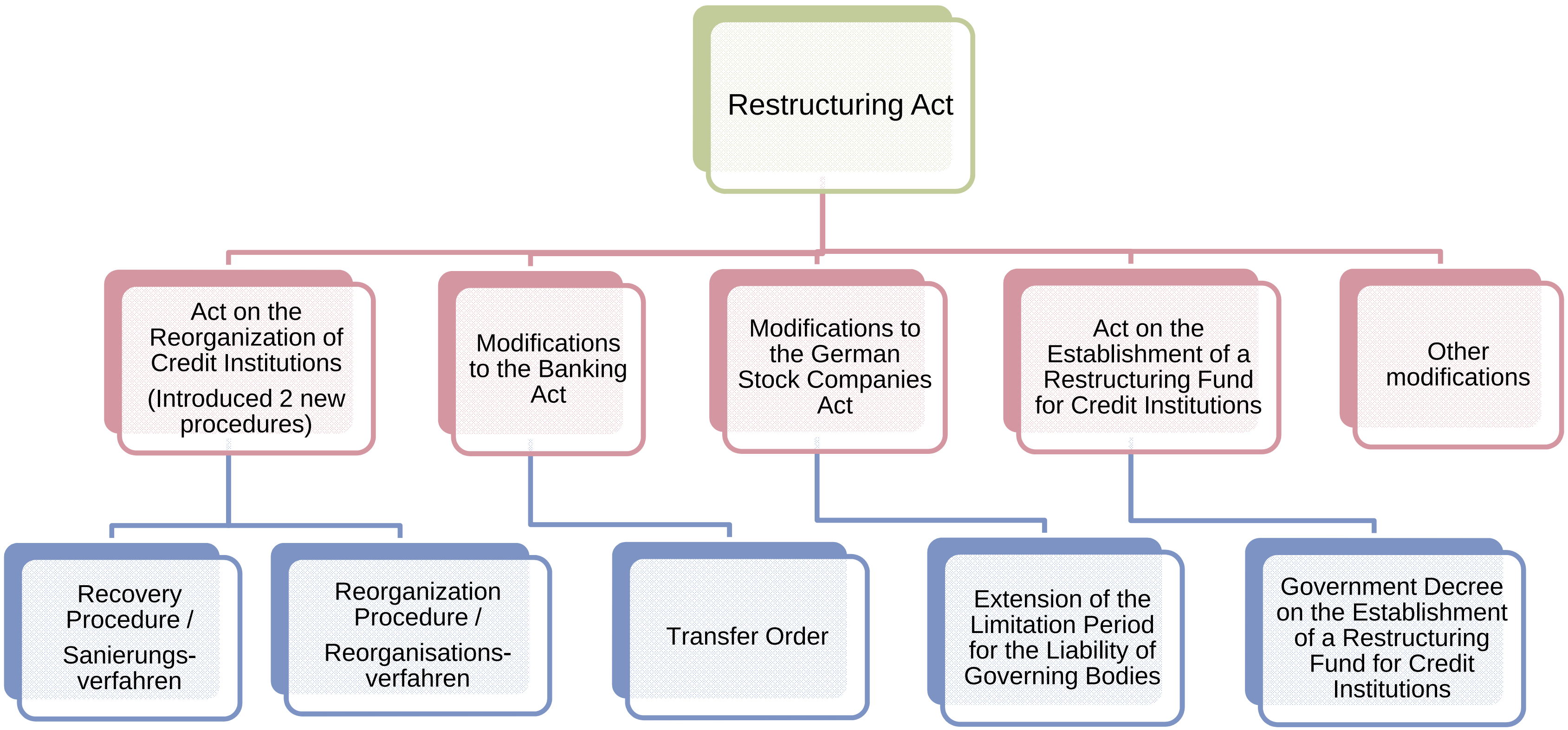
- FMSA in administering the Financial Market Stabilization Fund and the Restructuring Fund.

Structure of the German Bank Restructuring Act

Act on the Restructuring and Orderly Resolution of Credit Institutions, on the Establishment of a Restructuring Fund for Credit Institutions and on the Extension of the Limitation Period for the Liability of Governing Bodies under Company Law

- An omnibus act that introduced new statutes and made modifications to several existing statutes:
  - Introduction of an Act on the Reorganization of Credit Institutions (Kreditinstitute-Reorganisationsgesetz, KredReorgG)
  - Modifications to the German Banking Act (Kreditwesengesetz, KWG)
  - Implementation of the Liikanen Proposals in Germany
  - Introduction of an Act on the Establishment of a Restructuring Fund for Credit Institutions (Restrukturierungsfondsgesetz, RStruktFG)

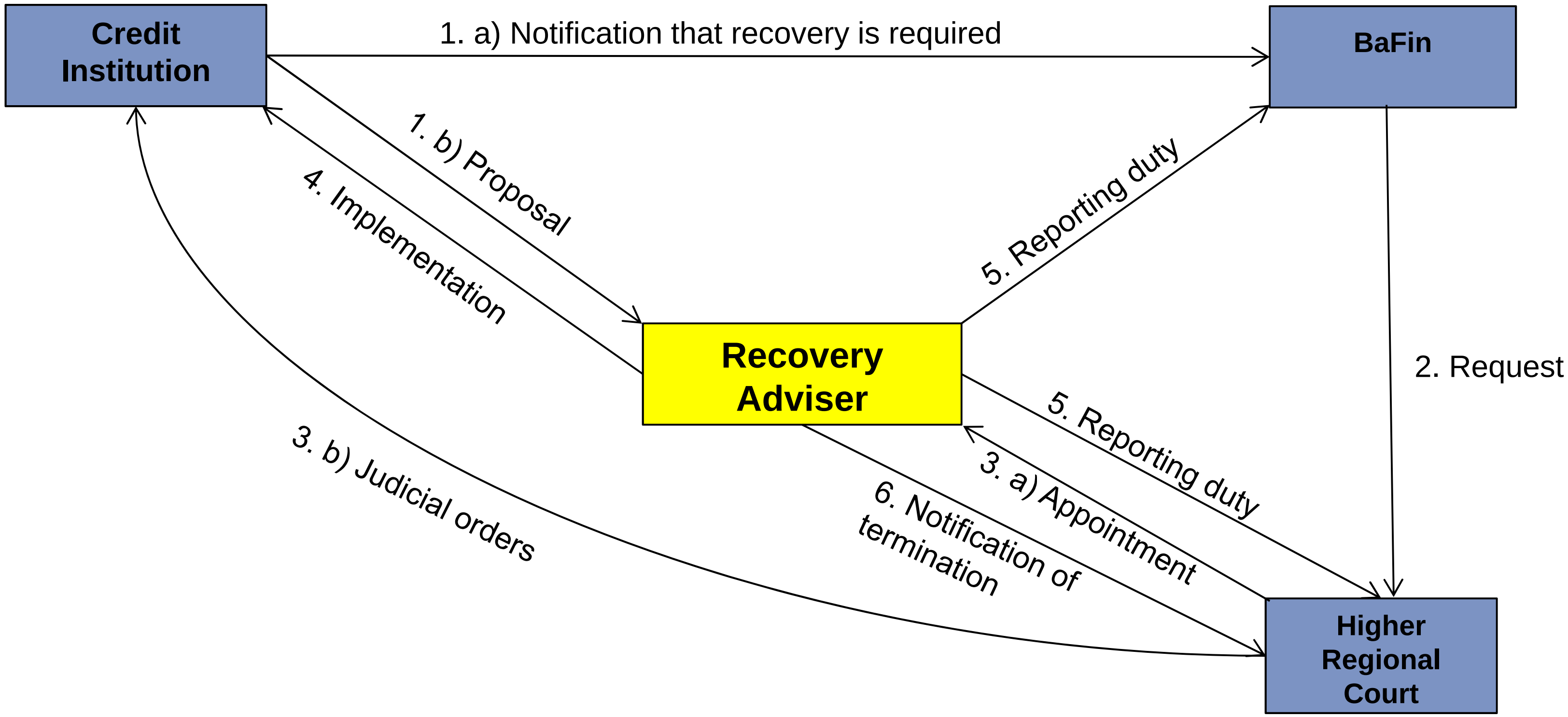
Matrix of the German Bank Restructuring Act



Act on the Reorganization of Credit Institutions

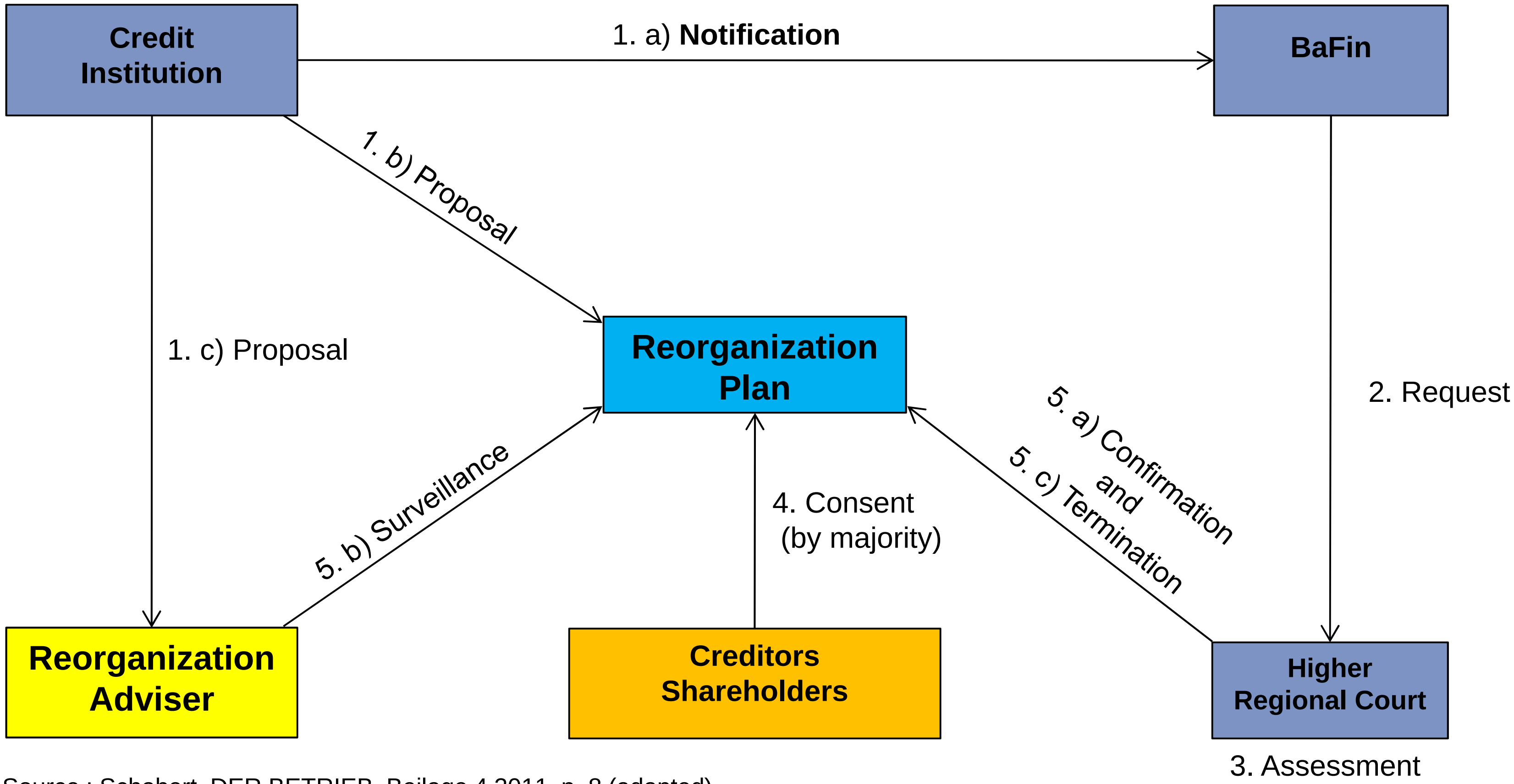
- Introduced two new procedures that do not limit the pre-existing and/or newly created rights of intervention under the Banking Act

Act on the Reorganization of Credit Institutions
A. Recovery Procedure („Sanierungsverfahren“)



Source : Schabert, DER BETRIEB, Beilage 4 2011, p. 7 (adapted)

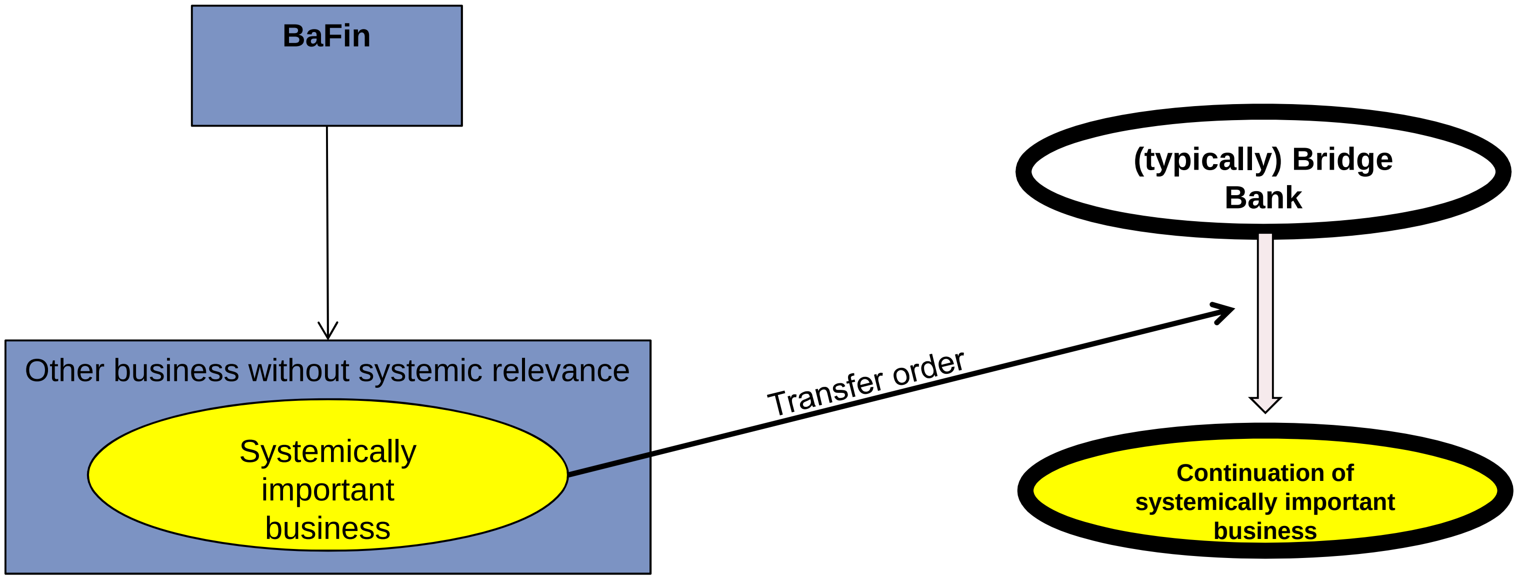
Act on the Reorganization of Credit Institutions
B. Reorganization Procedure („Reorganisationsverfahren“)



Source : Schabert, DER BETRIEB, Beilage 4 2011, p. 8 (adapted)

C. Transfer Order („Übertragungsanordnung“)

- **Transfer order enables the transfer of systemically important parts of a credit institution‘s business to a bridge bank or other operating credit institution**
  - Thereby, orderly liquidation of the systemically less relevant parts becomes possible in a standard insolvency procedure.



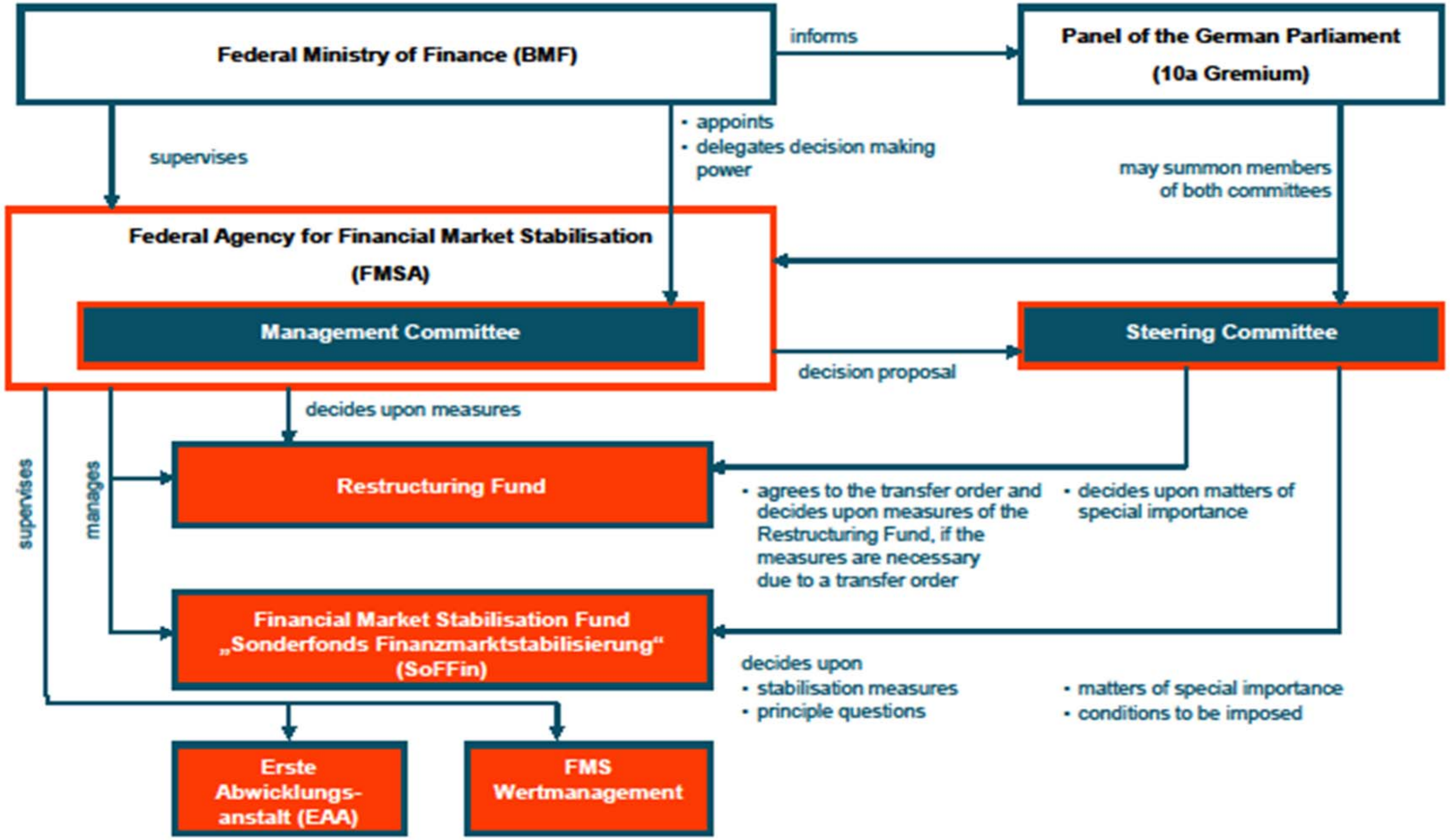
D. National Public Backstop Measures in Germany

- The Financial Market Stabilization Agency (FMSA), under the supervision of the German Federal Ministry of Finance, administers two funds providing backstops for the financing of restructuring and resolution measures with regard to financial entities in cases where private sources are insufficient to cover capital shortfalls.

- Restructuring Fund (Restrukturierungsfonds)

- Financial Market Stabilization Fund (SoFFin)

D. Administration Structure: Restructuring Fund and SoFFin



Source: FMSA

D. Restructuring Fund (Restrukturierungsfonds)

- Established at the beginning of 2011.
- Target size of the fund: 70 billion Euro (current level of paid-in capital roughly 1.5 billion Euro).
- Funded by a bank levy collected from all banks in Germany.
- In case of insufficient level of fund capital and if the Fund is unable to cover its funding needs via special contributions, it may borrow money on the markets.
  - Currently, the German parliament has issued a 100 billion Euro guarantee authorization and a 20 billion Euro authorization for borrowing for recapitalization measures.

Instruments available to the Restructuring Fund

- Establishment of “bridge banks”.
  - Enables transfer orders by which financial assets particularly deserving protection from a standpoint of financial stability may be transferred to the bridge bank as an absorbing legal entity.
- Recapitalization.
  - Purchase of newly issued bank shares.
  - Silent participation.
- Provision of guarantees.

D. Financial Market Stabilization Fund (SoFFin)

- Established in reaction to the Lehman collapse in October 2008.
- Granting of guarantees and recapitalization by the SoFFin initially restricted until 31 December 2010.
- Beyond 2010, SoFFin has been authorized to maintain its previously acquired capital participations, sell them and, if necessary, augment them in order to protect them against dilution.

- The Third Financial Market Stabilization Act (entry into force: 1 January 2013) created the possibility to grant measures under the Financial Market Stabilization Fund Act, restricted until the end of 2014.
  - Full perpetuation of the established set of SoFFin instruments.

Instruments available to the SoFFin

- Establishment of “bad banks” as resolution agencies.
  - “Bad bank” model implies that commercial owners of a bank remain economically responsible for the restructuring and resolution measures with regard to assets placed in the bad bank.
- Recapitalization.
  - Purchase of newly issued bank shares.
  - Silent participation.
- Provision of guarantees.
- Risk overtaking.
  - SoFFin may purchase risky assets or otherwise collateralize such assets.

D. Common Features of SoFFin and Restructuring Fund

- Initial differentiation: Parallel funds with a clear separation
  - Restructuring Fund, established in 2011 and financed by contributions by the financial industry
  - Financial Market Stabilization Fund established in October 2008 and financed by the tax payer

- Third Act on Financial Market Stabilization indents both funds
  - Restructuring Fund may now be drawn on to cover losses of the Financial Market Stabilization Fund, but protection for Restructuring Fund capital paid in in 2011 and 2012.
- Provision of recapitalization and guarantees to be remunerated at market rates.
  - Guarantees: 0.5% to 2% p.a.
  - Recapitalization through silent participation: ca. 9 to 10% p.a.
- Important decisions are made by the steering committee
  - Composed of representatives of the Federal Chancellery, Ministries of Economy, Finance, and Justice, a representative jointly nominated by the Länder, and an advisory representative of Bundesbank

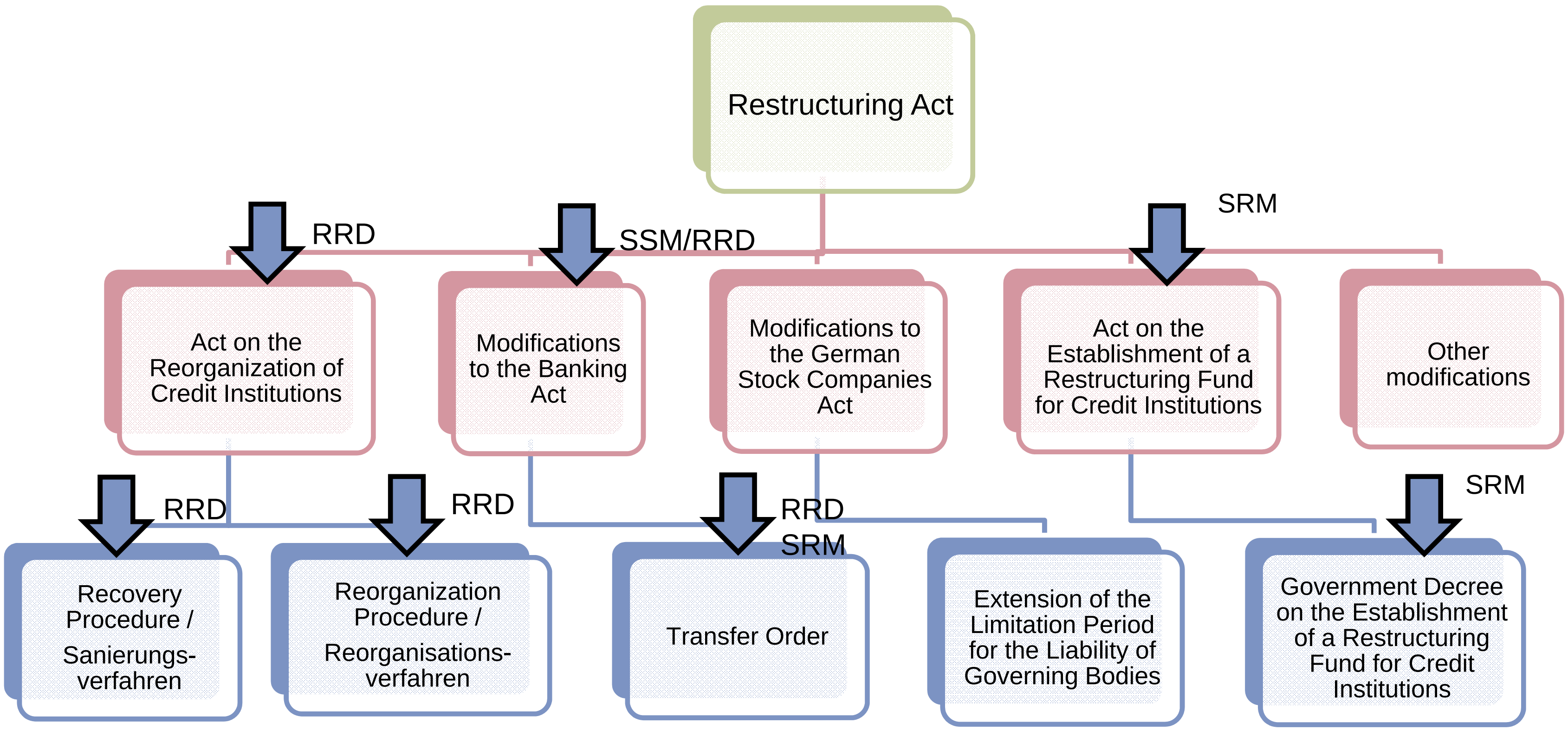
D. Financing of the Restructuring Fund

- Credit institutions obliged to contribute to the restructuring fund
  - Details set forth in a government decree on the contributions
  - Indicators for calculation of the fees reflect systemic relevance
  - Larger financial institutions (indicator: liabilities) and heavily interconnected institutions (indicator: volume of dealings in derivatives/futures) required to contribute more

- If periodic contributions are insufficient for necessary stabilization measures, special contributions may be levied

- Government decree foresees that periodic and special contributions will be subject to certain limits, reflecting the principle of proportionality
  - However, contributions not paid in one year because they were excessive for the credit institution will be transferred to the next year and will not be forfeited.
  - Protects taxpayers‘ money.
  - In the first years, due to restricted fund size, taxpayer involvement still very likely because ministry of finance will pre-finance gaps.

E. Areas prone to be affected by revisions due to Developments on the European Level (cp. slide 6)



F. The BRRD and Bank Restructuring and Resolution in Germany: BRRD Requirements

- Chapter III of the draft BRRD foresees a common toolkit, including
  - a roadmap to manage the failure of financial institutions in an orderly fashion (Articles 37-50 BRRD), involving
  - a bail-in mechanism available to the national competent authorities (Article 38.2 (a) BRRD).

- Bail-in mechanism will primarily call on the shareholders when financial support measures become necessary, followed by a precisely defined cascade of creditors (holders of convertible bonds, junior bonds, other eligible liabilities, notably unprotected bank deposits over 100,000 Euro).
  - Write-down of liabilities and conversion of debt or credit to equity are foreseen as authoritative measures under the BRRD.

- For Member States participating at the SSM, implementation of the BRRD through the SRM.
- However, national implementation of the BRRD still required.

F. The BRRD and Bank Restructuring and Resolution in Germany: Restriction of third-party rights under the current regime in Germany

- No explicit bail-in mechanism available in the current German framework.

- In the **Restructuring Procedure**, with the exception of the instrument of preferential loans, no interference in third-party property rights possible.

- In the **Reorganization Procedure**, accessible to SIFIs only, restrictions of third-party property rights possible under conditions:
  - Consent by a qualified majority of the affected group (shareholders/creditors).
  - Solves the “freerider problem”.
- Without a qualified majority of the affected creditors and/or shareholders consenting to the restriction of their property rights, no explicit bail-in possible.
  - Implementation of the bail-in tool provided for in the BRRD will hence most likely require a modification of the German legislative framework.
  - On the other hand, conditions for the provision of state aid set by the European Commission may force involved parties to agree.
  - Possible work-around through a transfer order and an assessment of the compensation to be provided to affected third parties taking into account bail-in elements (application of the telos of Art. 38 BRRD).

Thank you for your attention!