

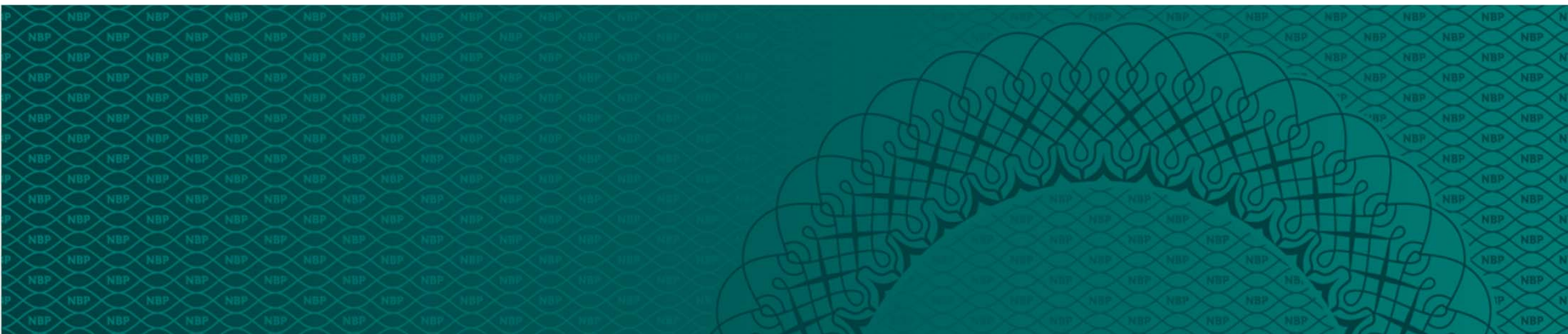
NBP

Narodowy Bank Polski

Tomasz Rybka / Legal Department

Bank Resolution - European and Polish Experience

Bucharest /1November 2013



Contents

- 1 The Notion of Bank Resolution (restructuring and orderly liquidation of banks) – General Issues
- 2 The draft directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms (the Draft Resolution and Recovery Plan – „RRP”)
- 3 Bank Resolution - European Experience
- 4 The Process of Bank Resolution in Poland
- 5 Summary

Bank Resolution – General Issues

The lack of a harmonised definition. The proposal for a broad definition of bank resolution according to the Polish Bank Guarantee Fund

(BGF presentation “The resolution process. Objectives, rules and applicability”, Warsaw, December 2011):

The out-of-court recovery process conducted by competent authorities in respect of the recovery and resolution of banks which do not meet the minimum requirements to carry on business activities, including capital requirements, aimed at:

- ensuring continuity of the bank’s critical functions, i.e. the core functions in its business activity whose performance is required to maintain its status as a going concern,

Bank Resolution – General Issues

- maintaining financial stability, among others by ensuring market discipline and protection of public trust in the banking sector,
- minimising the use of public funds,
- protecting depositors,
- seeking to preserve the value of bank assets.

Bank Resolution – General Issues

The reasons for the application of the bank resolution procedure:

- The financial crises affecting the banking sector, including the crisis in Mexico in 1994-1995, in Asia in 1997-1998, in Russia in 1998, in Turkey in 2001, in the U.S. in 2008,
- Laws remaining in force in many countries which provide for standard court bankruptcy procedures being ineffective and insufficient to take prompt and effective bank rehabilitation actions, to protect deposits and prevent adverse developments from spreading to other financial institutions,

Bank Resolution – General Issues

- The need to maintain client confidence in the banking sector stability by minimising the risk of panic related to potential shocks in financial markets,
- Introduction of a cheaper solution than the nationalisation of banks requiring the use of public funds,
- Ensuring the necessary promptness of proceedings with the use of administrative procedures (so-called weekend bank resolution),
- Actions necessary in the public interest to prevent the bankruptcy of the institution whose deposits are guaranteed by the state, thus by all taxpayers.

Bank Resolution – General Issues

Model solutions in respect of the standards of legislative regulation of bank resolution taking into account the above-mentioned comments are set out in the document entitled “*The Key Attributes of Effective Resolution Regimes for Financial Institutions*”, prepared by the Financial Stability Board (FSB), October 2011, composed of the representatives of the most developed countries.

In December 2010, the Economic and Financial Affairs Council (ECOFIN) adopted conclusions calling for the development of a crisis management system which should cover all types of banks, improve cross-border co-operation and consist of three pillars: preventive measures, early interventions and resolution tools and powers.

Bank Resolution – General Issues

The following objectives of the aforesaid activity were named:

- preserving financial stability by protecting public confidence in the banking system,
- preventing crisis situations,
- providing credible resolution tools enabling fast and decisive action in crisis situations,
- reducing moral hazard and minimising bank resolution costs, especially to public funds.

Bank Resolution – General Issues

The problem of bank resolution procedure interfering with property rights:

A demand that legal regulations governing the bank resolution procedure should take into account actions interfering with property rights without court proceedings through competent administrative authorities, e.g. expropriation of the bank shareholders or depriving them of their shares, only in cases justified by the public interest which is consistent with the requirements laid down in Article 1 of Protocol No 1 to the European Convention for the Protection of Human Rights and Fundamental Freedoms made in Paris on 20 March 1952, reading as follows:

“Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law. (...).”

The Draft RRP Directive

The objective of the Draft RRP Directive:

- harmonising national laws in EU countries on recovery and resolution of credit institutions and investment firms (not only banks), i.e. taking preventive measures connected with the current financial situation within the EU,
- ensuring substantial intervention measures, both to prevent problems and to react fast if those occur,
- ensuring that the bank's critical functions will be preserved if the bank financial situation has impaired, and that resolution costs will be iborned by shareholders and creditors, and not by taxpayers, as was the case in the majority of crisis situations which occurred to date in certain EU states,
- preventing the contagion of other financial markets in the EU,
- ensuring financial stability of interconnected EU financial markets.

The Draft RRP Directive

Key elements of the Draft RRP Directive:

Three operating pillars:

- preparatory and preventative measures,
- early intervention measures,
- resolution tools and powers.

The possibility of intervention by relevant authorities of the EU Member State through bank resolution increases as the situation in the banking sector becomes more difficult.

The Draft RRP Directive

Resolution tools:

The resolution is carried out when the preventive and early intervention measures are not sufficient to prevent the bank situation deteriorating to the extent the bank becomes insolvent or its insolvency is likely.

If the relevant authority concludes that no alternative action will prevent the bankruptcy of the bank and that the public interest is at risk (access to bank's critical functions, stability of the financial system or public finances etc.), it needs to take over the control over a given financial institution and take decisive resolution measures.

The Draft RRP Directive

Resolution techniques:

- sale of business where the authorities sell the failing bank, in whole or in part, to another bank,
- bridge institution involving the identification of sound assets or critical functions of the bank and transferring them to a new bank (bridge bank) which is sold to another entity. The „old” bank – holding “bad” assets or functions other than the core ones – is subsequently liquidated in an orderly winding-up proceeding,

The Draft RRP Directive

- the asset separation involving the transfer of “bad” assets to a dedicated entity managing those assets. This tool allows to clean the bank balance sheet. In order to prevent the use of this tool solely as public aid measure, the framework contains a reservation that it may only be used together with another instrument (bridge bank, sale of business or debt restructuring). It guarantees the restructuring of the bank receiving support,

The Draft RRP Directive

- the bail-in under which the bank would be recapitalised while the existing shares would be amortised or diluted and creditor claims would be reduced or exchanged for shares. An institution for which a private buyer would not be found or whose split is too complicated would be still able to provide basic services, without the need to conduct any rescue operations with the use of public funds and supervisory authorities would have time for the resolution thereof or orderly liquidation of its part. To that end banks will be obliged to hold a specified minimum percentage of their total liabilities in the form of instruments qualifying for use as part of the aforesaid tool. If appropriate, their value would be reduced in a specific pre-defined sequence, depending on the priority assigned to a given claim, in order to restore the profitability of a given institution.

Bank resolution - European Experience

In the case of application of legal solutions in Europe with regard to bank resolution, the following models may be distinguished according to “*Resolution policies and frameworks – progress so far*” by the Basel Committee on Banking Supervision, Bank for International Settlements, July 2011:

- Special resolution regime, i.e. a comprehensive legal regulation which is far more effective than the current standard regulations on restructuring and liquidation,

Application: e.g. United Kingdom, Germany, Spain

Bank resolution - European Experience

- Special administration or management regime, i.e. ad hoc application of rehabilitation measures by administrative authorities through “special officials” having various legal status who take over the functions of the existing management bodies of banking institutions. However, this solution does not ensure the accomplishment of the resolution objectives and functions on a comprehensive basis,

Application: e.g. Italy, Belgium, France

- mixed regime - a mixed model under which the decisions taken under bank resolution need to be consulted with creditors or shareholders. The authority carrying out the resolution procedure has limited powers and court proceedings are still involved.

Application: e.g. Luxembourg

Bank resolution - European Experience

The current European experience with regard to bank resolution indicates that there is no benchmark model for institutions involved in initiating and carrying out the process. According to the current legal solutions, the functions of the resolution authority may be performed by:

- central banks,

Application: e.g. United Kingdom, Greece, Portugal, Ireland, the Czech Republic

- various administrative authorities (a multi-level model),

Application: e.g. Germany, Romania, Denmark, Belgium

Bank resolution - European Experience

- funds which guarantee the payment of bank deposits (DGS),

Application: in Europe as participating institutions. Broad powers in other states, including the U.S., Turkey, Canada, Malaysia.

It needs to be noted that there is a need in Europe for developing bank resolution solutions while taking into consideration substantial differences among financial resources accumulated by funds which guarantee the payment of bank deposits in individual states.

Therefore, the Draft RRP Directive recommends that funds for that purpose be created *ex ante* in a long-term perspective of 10 years.

The Process of the Bank Resolution in Poland

The legislative efforts on the draft act on the bank resolution in Poland:

The Financial Stability Committee (FSC) whose members include the Finance Minister, the President of the National Bank of Poland, the Chairperson of the Polish Financial Supervision Authority and the President of the Bank Guarantee Fund was established to ensure the effective co-operation in the area of supporting and maintaining domestic financial system stability by sharing information, opinions on and assessments of the financial system condition, both in Poland and abroad, and co-ordinate actions in this respect. In October 2011, FSC made a decision on establishing the Task Force, chaired by the President of the Bank Guarantee Fund, to develop legal solutions on bank resolution in Poland.

As a result of the Task Force efforts, the draft act regulating the bank resolution process was prepared, which is currently subject to further consultations. Therefore, the finally accepted legal solutions may vary from those presented below.

The Process of the Bank Resolution in Poland

Key elements of the draft act on bank resolution in Poland:

According to the draft act, the institution initiating the bank resolution procedure will be the Polish Financial Supervision Authority which will issue an administrative decision on the commencement of the procedure in a situation where other rehabilitation options in respect of preparatory measures and early intervention fail to meet expectations.

The reasons for taking the aforesaid decision:

- the solvency of the bank is at risk,
- there are no symptoms indicating that the possible supervisory efforts or the bank's efforts will allow to eliminate the threat to solvency in a short time,
- actions towards the bank are necessary in the public interest,

The Process of the Bank Resolution in Poland

The solvency of the bank is at risk due to the following reasons:

- the solvency ratio as at the statement date is below 5.33 %,
- the loss as at the statement date exceeds half of the bank equity,
- the supervisory short-term liquidity standards below the 2/3 of the required level,
- the bank became illiquid,

The Process of the Bank Resolution in Poland

- the bank business activity is carried out in breach of the law or the statute which may lead to insolvency or illiquidity,
- the bank does not follow recommendations and directives issued by the Polish Financial Supervision Authority in regard to the minimum statutory solvency ratio of 8% or short-term liquidity standards,
- the licence to establish the bank has been revoked.

It should be noted that the decision on commencing bank resolution procedure will be based on the assessment of the bank's situation by the Polish Financial Supervision Authority in a broader context, and not only on the basis of single ratios in order to anticipate crisis situations as a preventive measure, and not only in view of clear signals of crisis in the financial market.

The Process of the Bank Resolution in Poland

The Bank Guarantee Fund as the executor of the bank resolution procedure:

The Bank Guarantee Fund will also be able to recommend to the Polish Financial Supervision Authority that the bank resolution procedure be initiated.

The commencement of the bank resolution procedure is not tantamount to revoking immediately the bank licence and to its bankruptcy. Such bank remains a going concern, taking into consideration the application of relevant rehabilitation tools by the Bank Guarantee Fund, but its creditors may not demand that their claims be immediately satisfied.

Creditors will be repaid in accordance with the rules laid down in the act of 28 February 2003 - Bankruptcy and Rehabilitation Law in line with the priority of specific debt categories.

The Process of the Bank Resolution in Poland

The commencement of the bank resolution will result in taking over the management of the bank under this procedure by experts acting on behalf of the Bank Guarantee Fund as the nominal administrator of the bank undergoing the bank resolution procedure.

Their activities involve, in the first place, the estimation of the actual value of assets, collaterals and potential losses. The Bank Guarantee Fund as the executor of the bank resolution procedure will be able to transfer or dispose of the bank business, either in a whole or in part, without the need to obtain the consent from the debtors, shareholders or creditors of the bank under resolution in view of the public interest, which is subject to verification by the administrative court at the request of the parties concerned.

As part of the bank resolution procedure, the Bank Guarantee Fund will be able to take the following rehabilitation measures:

- sale of the bank business, either in whole or in part,

The Process of the Bank Resolution in Poland

- The establishment of a bridge bank, operating in compliance with the requirements of the banking law which could be established earlier in view of a relatively time consuming bank registration procedure and used as a ready-made tool in a crisis situation by selling it in whole or in part once the appropriated assets and liabilities have been organised and the buyer has been found,
- writing down certain liabilities or converting them into the bank's share capital, thus enabling the bank to continue its business operations, provided that the shareholders and creditors give consent to provide the bank with new capital,
- transfer of assets to a special purpose entity which will manage those assets in a situation where the sales of assets is not recommended in view of the current market situation. Such an entity will restructure the assets in order to achieve the biggest proceeds when making settlements with the bank creditors.

Summary

In view of the varying situations of banks in Europe caused by the existence of both large entities which are important institutions for the European financial system and numerous smaller banks, for example in the Polish banking sector, adequate tools are required which, on the one hand, mitigate the risk generated by large banks and, on the other hand, structure the fragmented banking sectors.

The bank resolution procedure represents one of the ways to fight the negative consequences of potential crisis situations in the financial markets.

The existing European experience indicates this is a desired direction for legislative solutions in view of the possibility of having at one's disposal the tools eliminating or, at least, mitigating negative consequences of such situations in the banking sector.

For the abovementioned reasons Poland also intends to incorporate the bank resolution solutions in its legal system.

Thank you for your attention

The presentation was prepared on the basis of materials published by the European Parliament and the Council of the European Union, the Financial Stability Board, the Ministry of Finance, the National Bank of Poland, the Bank Guarantee Fund and the Polish Financial Supervision Authority for the purposes of the National Bank of Romania seminar to be held on 1 November 2013 on "Key legal aspects of bank resolution".



Tomasz Rybka

legal counsel

phone +48 22 595 91 71

tomasz.rybka@nbp.pl

We protect the value of money