

Bank Restructuring Legislation in Germany

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Overview on German bank restructuring legislation (1)

- 2008/2009: **First Financial Markets Stabilisation Act**
 - > Establishment of the Financial Markets Stabilisation Fund (SoFFin) and German Federal Agency for Financial Markets Stabilisation (FMSA)
 - > Key rescue and support measures (to be granted until end of 2010):
 - > **Capital injections**
 - > **Guarantees by SoFFin for debt issued by banks**
 - > **Assumptions of risk positions**
 - > **Bad bank scheme, SPV scheme**
- 2011: **Restructuring Act**
 - > Restructuring tools:
 - > **Reorganisation tool**
 - > **Bridge bank tool**

Overview on German bank restructuring legislation (2)

- 2012: **Financial Markets Stabilisation Act is reactivated ("SoFFin II")**
 - > Basically same rescue and support measures as under the First Financial Markets Stabilisation Act
 - > but slight modifications
 - > new powers of the German regulator BaFin to **raise the core tier 1 capital above the required minimum ratio**
 - > Rescue and support measures under the Financial Markets Stabilisation Act may generally be applied in parallel to the restructuring tools under the Restructuring Act
 - > The Financial Markets Stabilisation regime under SoFFin II is due to be discontinued at the end of 2012

Key restructuring tools

- **Bad bank scheme**
- **Reorganisation tool**
 - > Restructuring proceeding (*Sanierungsverfahren*) (first level)
 - > Reorganisation proceeding (*Reorganisationsverfahren*) (second level)
- **Bridge bank tool**

Bad bank scheme

- **Key features**

- > Purpose: Stabilisation of credit institution (reduction of regulatory capital and liquidity requirements)
 - > Transfer of risk positions (in particular “toxic assets”) and entire non-strategic business lines to bad bank
 - > Bad bank as public-law resolution agency regulated by FMSA and specifically formed upon application of credit institution
 - > Bad bank is not a credit institution as understood by the EU Banking Directive
 - > Ultimately, owners of the supported credit institution shall bear the risk of losses from the winding-up of the transferred assets
- Similar to **asset separation tool** as set out in Art. 36 of the draft Directive establishing a framework for the recovery and resolution of the credit institutions and investment firms (“**EU Crisis Management Directive**”), even though the latter procedure is not triggered by the credit institution but the resolution authority

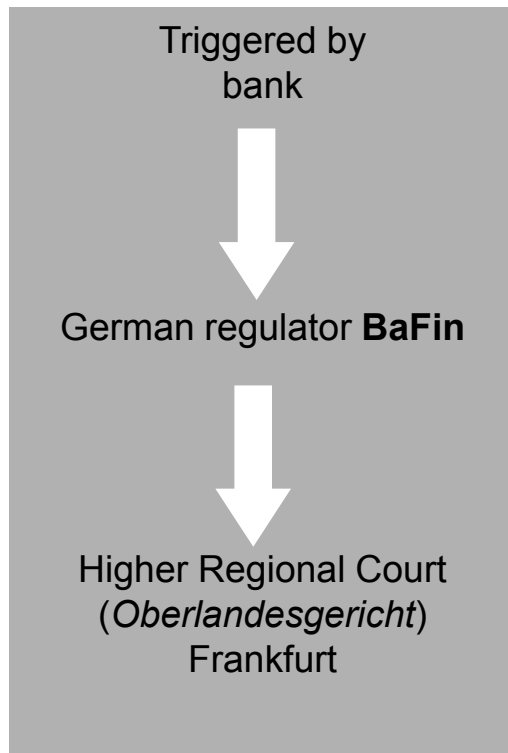
Reorganisation tool (1)

- **Key features**

- > Triggered by credit institution itself
- > **First level:** 'Soft' restructuring proceeding (*Sanierungsverfahren*)
 - > Non-public proceeding and a court appointed restructuring advisor with no significant powers
 - > Third parties' rights must not be infringed
- > **Second level:** Reorganisation proceeding (*Reorganisationsverfahren*)
 - > For banks of systemic importance only; public proceeding
 - > Partly similar to an insolvency plan procedure/chapter 11 procedure; key elements are a reorganisation advisor and a reorganisation plan which needs to be approved by creditors / shareholders
 - > reorganisation plan might infringe third parties' rights: Debt-to-equity swap, hive-down of assets and impairment of creditors' claims possible
- > Debts incurred during restructuring/reorganisation proceedings (even by shareholders) can be granted super-priority status in any subsequent insolvency proceeding over the bank
- > Court may prohibit payment of dividends and check rules on bonuses

Reorganisation tool (2)

Proceeding



Credit institution files notice (*Anzeige*) of the need of reorganisation with BaFin

- > Submitting reorganisation plan
- > Proposing reorganisation advisor

BaFin files application (*Antrag*) with Court to open restructuring proceeding

- > Together with reorganisation plan
- > Proposing reorganisation advisor

Court decides about opening of the restructuring proceeding

- > Appoint reorganisation advisor
- > Review for "evident mistakes"
- > Decision final and conclusive
- > Insolvency like proceedings

Reorganisation tool (3)

- Not yet tested in practice
- **Critical issues**
 - > Imminent risk of bank run if it becomes publically known that a bank is in need of a restructuring
 - > Since bank restructurings are typically time-sensitive, implementing the reorganisation tool may turn out to be too time-consuming

Bridge bank tool (1)

- **Key features**

- > Mandatory proceeding initiated by German regulator BaFin: BaFin issues administrative order for hive-down (*Übertragungsanordnung*)
- > The idea is to hive-down assets and liabilities that are significant for the financial system to a legal entity (“bridge bank”) while the assets which are not significant for the financial system remain with the credit institution that goes insolvent without jeopardising the financial system
- > The prerequisites are that
 - > the bank is affected in its existence and the situation jeopardises the financial system
 - > the acquiring entity bridge bank give its consent prior to the transfer
- > The remaining bank will possibly go into insolvent liquidation
- > Transfer order for hive-down may only be issued by BaFin as an *ultima ratio* due to its severe impact on shareholders/creditors

Bridge bank tool (2)

- **Implementation of transfer order**

- > The assets and liabilities to be transferred are determined primarily by their systemic relevance and secondly, in respect of liabilities, by their priority in insolvency proceedings
- > Proper valuation of the Assets is a key; if the value of the total Assets transferred
 - > is positive, the credit institution is entitled to consideration (shares/cash)
 - > is negative, the credit institution should pay compensation to the acquiring legal entity
- > Assets and liabilities that form part of the hive-down are transferred by way of (partial) universal succession (*Gesamtrechtsnachfolge*)
- > The hive-down – i. e. the transfer of the relevant assets and liabilities – becomes effective and the claim for consideration becomes due with the issuance and the publication of the transfer order

Bridge bank tool (3)

- **Critical issues**
 - > Functioning and funding of the bridge bank on day one (- being a credit institution, bridge bank needs to comply with regulatory requirements)
 - > Treatment of foreign located assets
 - > Close-out netting and impact of set-off
 - > Resolution planning will reflect bridge bank tool
- German bridge bank tool is – in parts – comparable to the **bridge institution tool** pursuant to Art. 34 of the draft EU Crisis Management Directive. It also includes elements of the **sale of business tool** as set forth in Art. 32 of the draft Directive.

Conclusion and Outlook

- Some of the existing German restructuring tools – in particular the bad-bank scheme and the bridge bank tool – are already comparable to the resolution tools provided for in the draft EU Crisis Management Directive
- Still, the implementation of the resolution tools of the draft EU Crisis Management Directive into German law will entail a need for adjustment.
 - > This particularly holds true for the **bail-in tool** and the **write down tool** as set forth in the draft Directive

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