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Implementation of Group Resolution

The German Perspective

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Overview

I. Legal Background

1. FSB Key Attributes of Effective Resolution Regimes for Financial Institutions
2. Implementation timeline
3. Intended resolution tools and powers of a possible EU Crisis Management Framework

II. The German Restructuring Act (Restrukturierungsgesetz)

1. Act on the Reorganisation of Credit Institutions (“KredReorgG”)
2. Transfer order
3. Restructuring fund
4. Group perspective

III. Challenges in implementing group resolution measures

I. Background - Objectives

Effective resolution regimes (FSB, EU, Germany...) for instance

- enhance financial stability, reduce moral hazard, protect depositors
- ensure continuity of systemically important financial services, and payment, clearing and settlement functions
- allocate losses to firm owners (shareholders) and unsecured and uninsured creditors in a manner that respects the hierarchy of claims
- allow authorities to resolve financial institutions in an orderly manner without taxpayer exposure to loss from solvency support and not create an expectation that such support will be available

I. Background - Legal

The Key Attributes

- were published on 4 November 2011
- set out:
 - responsibilities, instruments and **powers** that national resolution regimes should be given to resolve a failing systemically important financial institution (SIFI),
 - requirements for **resolvability assessments and recovery and resolution planning** and
 - requirements for the development of institution-specific **cooperation agreements**

I. Background - Powers

Resolution powers inter alia (1):

- Remove and replace the senior management
- Appoint an administrator to take control of and manage the affected firm with the objective of restoring the firm
- Operate and resolve the firm, including powers to terminate contracts, continue or assign contracts, **purchase or sell assets, write down debt**
- **Override** rights of shareholders of the firm in resolution (approval by shareholders of particular transactions, in order to permit a merger, acquisition, sale of substantial business operations, recapitalisation or other measures to restructure and dispose of the firm's business or its liabilities and assets)

I. Background - Powers

Resolution powers inter alia (2):

- **Transfer** or sell assets and liabilities, legal rights and obligations, including deposit liabilities and ownership in shares, to a solvent third party
- Establish a temporary **bridge institution** to take over and continue operating certain critical functions and viable operations
- Establish a separate **asset management** vehicle (for example, as a subsidiary of the distressed firm, an entity with a separate charter, or as a trust or asset management company) and transfer to the vehicle for management and run-down non-performing loans or difficult-to-value assets

I. Background - Powers

Resolution powers inter alia (3):

- **Early termination rights** are temporarily suspended: that may otherwise be triggered upon entry of a firm into resolution or in connection with the use of resolution powers
- Ensure **continuity of essential services and functions** by requiring other companies in the same group to continue to provide essential services to the entity in resolution, any successor or an acquiring entity; ensuring that the residual entity in resolution can temporarily provide such services to a successor or an acquiring entity; or procuring necessary services from unaffiliated third parties

I. Background – Resolvability Assessment

Resolvability Assessment:

- **Objective:** Making authorities and firms aware of resolution implications, identification of factors and conditions affecting effective implementation, determination of specific actions to achieve greater resolvability
- Assessment is a continuous process, qualitative in nature, results should inform recovery and resolution planning
- Assessment designed as a three-stage process
 - Identification of feasible resolution strategies
 - Determination of credibility of all feasible strategies
 - Taking actions to assure that resolution is feasible and credible

I. Background – Recovery & Resolution Plan

Recovery and Resolution Plan

- The **recovery plan** identifies options to restore financial strength and viability when the firm comes under severe stress
- The **resolution plan** is intended to facilitate the effective use of resolution powers.

“... to protect *systemically important functions*, with the aim of making the resolution of any firm feasible without severe disruption and without exposing taxpayers to loss.”

I. Background - Timeline

Implementation Timeline

Recovery and Resolution Plans	
Intermediate report on progress	June 2012
Completed RRP by all G-SIFIs	December 2012
Status report by ResG/CBCM	January 2013
Resolvability Assessment	
Report on initial resolvability assessment	June 2012
Resolvability assessment completed by all G-SIFIs	October 2012
Report on remaining impediments and actions taken	December 2012

I. Background – EU

The following resolution tools and powers (i.a.) are comparable to some of the Key Attributes as mentioned before:

- **Sale of business** (parts of the credit institution or parts of its business can be sold to one or more purchasers without the consent of shareholders)
- **Bridge bank** (authorities can transfer some or all of the business to a temporary bridge bank in order to preserve essential banking functions or facilitate continuous access to deposits)
- **Asset separation** (to remove toxic assets to a separate vehicle)
- **Debt write-down** ('bail in')
- Replace senior management, appoint an administrator, temporary suspension of early termination rights (stay)...

I. Background – Status Quo

Status Quo (1):

- Germany is fully committed to taking the necessary steps to comply with the requirements set forth in the Key Attributes
- The implementation is linked to the timeline at EU level

Steps already taken or in planning...

- Restructuring Act (*Restrukturierungsgesetz*)
- Restructuring Fund
- The authorities are also already in a position to remove or replace senior management, appoint an administrator or impose a moratorium

However, the scope of tools available is not as comprehensive and explicit as in the Key Attributes or the EU-Proposal...

I. Background – Status Quo

Status Quo (2):

- We are currently developing requirements for recovery and resolution plans and are intending to publish the requirements for consultation in autumn
- The processes for cooperation and information sharing arrangements within Crisis Management Groups have already been initiated
- We have already started resolvability assessments
- With regard to further legislative measures, a proposal for a Directive on Crisis Management and Resolution is currently being developed at EU level. We expect that full implementation of the EU framework will largely lead to compliance with the FSB Key Attributes

II. Restructuring Act

Legislator's intention:

- During the **financial (subprime) crisis**, the existing legal arrangements and prudential supervisory instruments proved **inadequate for resolving SIBs without jeopardising the stability of the financial system** as a whole (**too big to fail**).
- The outlook of receiving governmental support incentivises banks to take greater risks as compared to a situation without such "implicit governmental support" (**moral hazard**).
- However, if **state support** is required in the course of rescue operations, there **should be room for governmental influence** (in respect of the bank and its operations).

II. Restructuring Act

Essential elements:

- Act on the Reorganisation of Credit Institutions (the “**KredReorgG**”) with a two-stage restructuring-procedure
- Amendments to the German Banking Act (the “**KWG**”)
 - Transfer order (Sec. 48a et seqq. KWG)
 - Strengthening of BaFin’s crisis prevention powers (e.g., appointment of a special representative)
- Creation of a Restructuring Fund

II. KredReorgG

- Aim of the **KredReorgG**: Restructuring / Reorganisation based on the **credit institution's initiative and own efforts**
- Two types of procedures:
 - **Restructuring procedure**: third-party rights generally remain unaffected
 - **Reorganisation procedure**: third-party rights can be adjusted

II. KredReorgG

Generally:

- Procedures are initiated **by the credit institution not by the authority** (supervisory or resolution):
 - Notification by the institution (addressee: BaFin)
 - Preparation of a restructuring-/reorganisation plan
 - Proposal for an advisor to be appointed in order to supervise the procedure
- After examination BaFin files for initiation of procedure (addressee: court) together with its own (positive) statement
- Court decides on the procedures

II. KredReorgG

Application:

Restructuring procedure:

Applicable, if under the present circumstances the institution will not be able to meet its regulatory capital and / or liquidity requirements (prognosis)

Reorganisation procedure:

- a restructuring procedure does not look promising or
- an earlier restructuring procedure failed and
- the institution's existence is under threat (**going-concern risk**) so that a systemic risk arises

II. KredReorgG

Differences:

- **Restructuring plan does not affect third- party rights**
- **Reorganisation plan** may also provide adjustments of third-party rights (e.g. deferral, haircut, debt-equity-swap, capital reduction or capital increase, winding-up or transfer of problem assets or business parts)
 - if the plan is accepted, the **court confirms the plan**
 - if the **required majority is not reached**, KredReorgG provides for a **prohibition to obstruct** (i.e., creditors are deemed to have agreed, if certain conditions are met)

II. Transfer order

- **Objectives:**

The transfer order (Sec. 48a et seqq. Of the KWG) **extends the measures available to BaFin** to stabilise a SIB even without the consent of the bank's management, creditors, and shareholders, if **required to protect financial markets' stability**

- **Preconditions**, Sect 48a of the KWG:

- **going-concern risk** and **systemic risk**
- **last resort:** the systemic risk arising from the going-concern risk cannot be eliminated other than by a transfer order

II. Transfer order

“Types” of transfer orders: Transfer of (a) the entire enterprise (**full transfer**) or (b) the systemically relevant parts (**partial transfer**) in each case to a bridge bank (via **spin-off**)

Consideration / compensation claim, Sec. 48d of the KWG:

If the overall value of the assets to be transferred by the transfer order is:

- **positive**, the **credit institution** (not its shareholders) **receives a consideration** (shares in the bridge bank or cash)
- **negative**, the transfer order shall oblige the credit institution to compensate the transferee (= bridge bank) in cash (**compensation claim**)

II. Transfer order

Partial retransfers / sequential transfers / stay

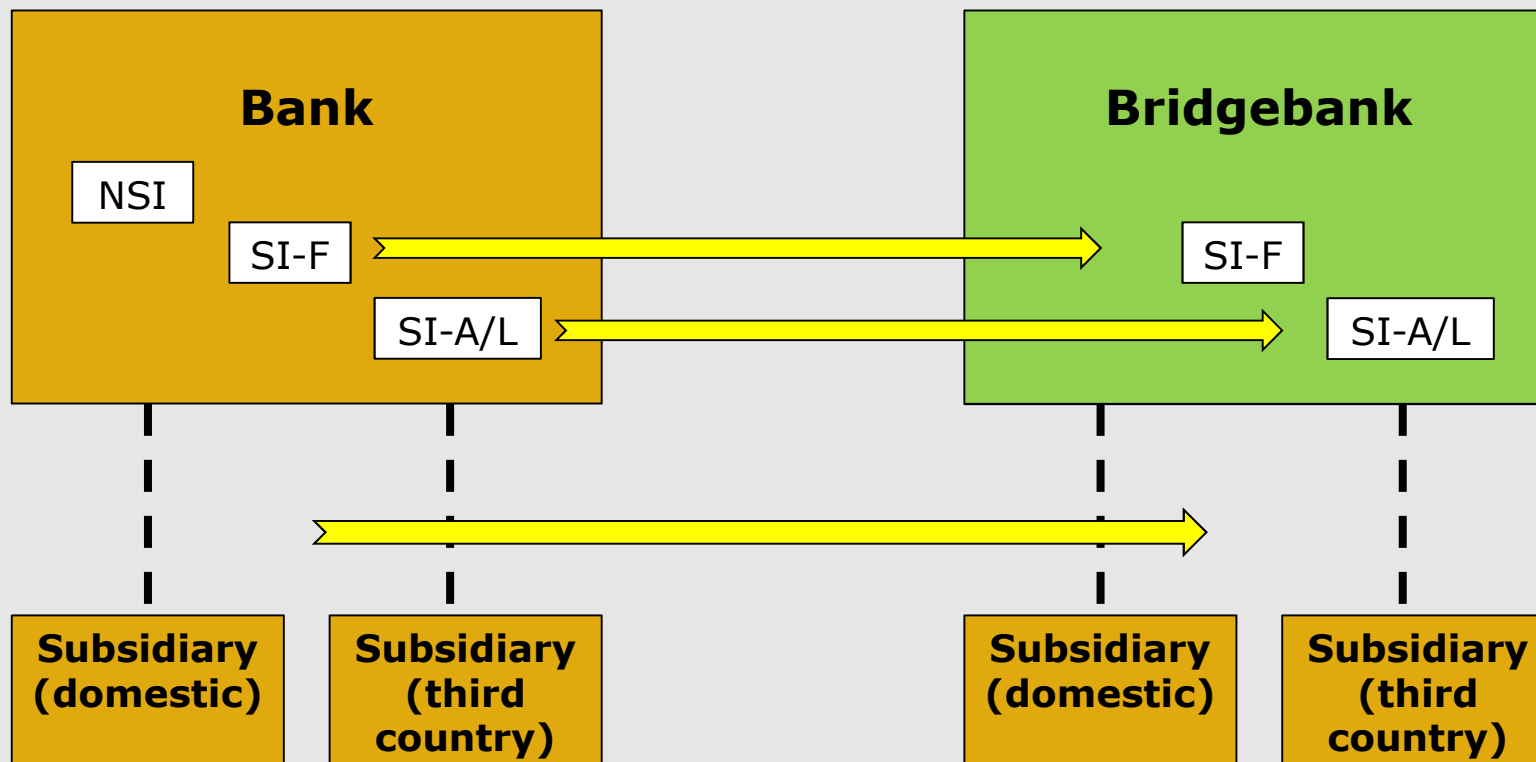
- Possibility to partially **retransfer spin-off assets** within 4 months after the spin-off taking effect, Sec. 48j KWG
- In case of a **partial transfer** of assets, liabilities or legal relationships, BaFin is authorized **to transfer further assets** within 4 months after the spin-off taking effect, Sec. 48k KWG
- Assets which remain with the institution might be **subject of orderly insolvency-proceedings** in which case they would most likely **suffer a hair-cut**
- **Temporary suspension** of early termination rights (stay)

II. Restructuring Fund

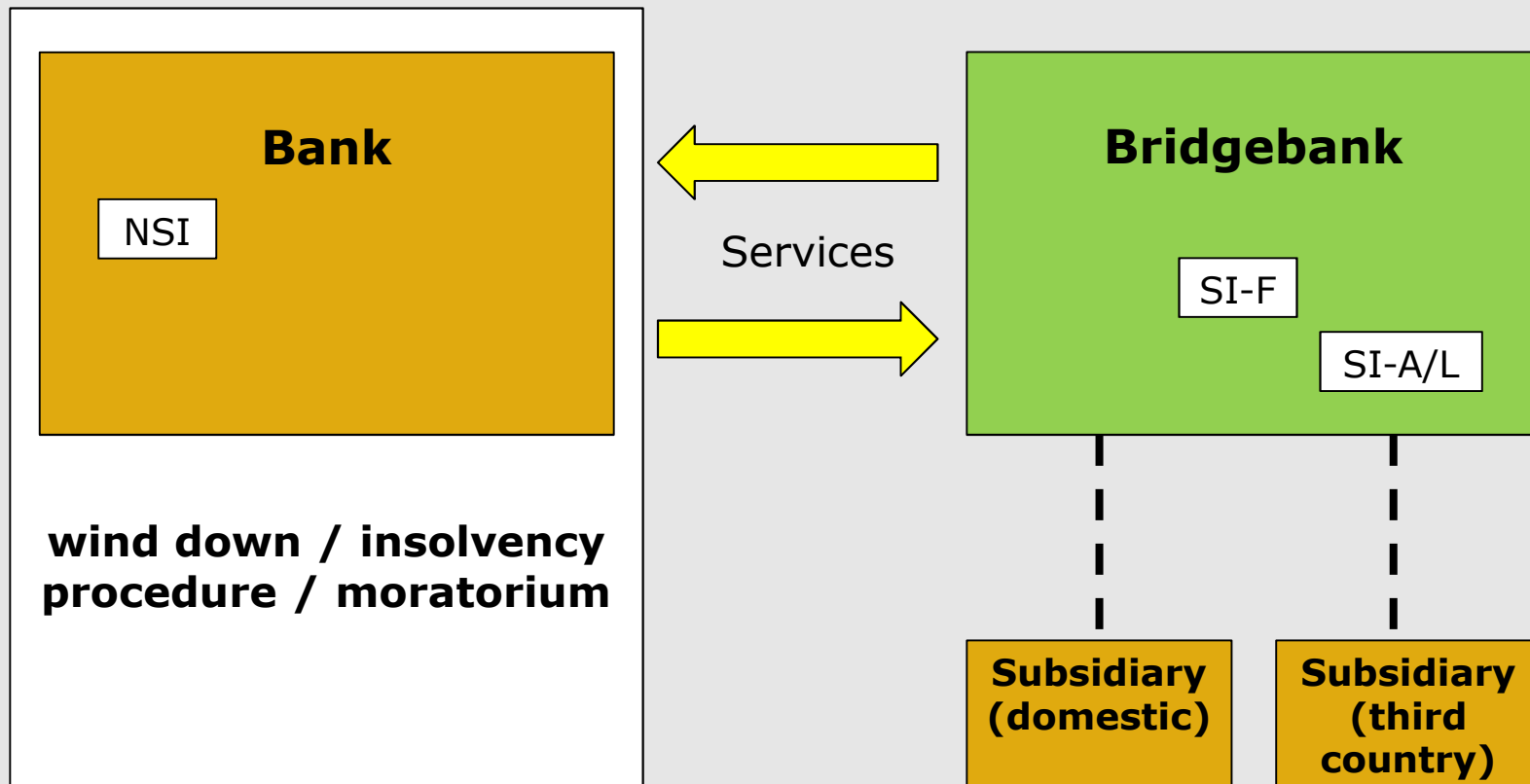
Restructuring Fund

- **Basically all credit institutions** have to make contributions to the fund
- The **contribution** is calculated based on **certain liabilities and derivatives positions**
- The **Financial Market Stabilisation Agency** administers the Restructuring Fund

II. Group perspective



II. Group perspective



III. Challenges

Potential impediments to resolution

- Complexity of the organisational structure
- Ensuring essential services
- Liquidity needs, funding mechanism
- Document management / IT infrastructure

III. Challenges

Potential impediments to resolution

- Coordinated cross-border resolution
- Information sharing
- Close out netting, default, change of control, rights of termination...
- Ring-fencing and liquidity triggers
- Burden sharing

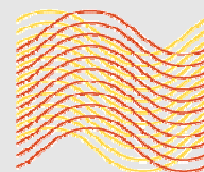
III. Challenges

Potential impediments to resolution

- Divergent insolvency legal frameworks
- National resolution powers are not fully aligned of uncertainty with respect to:
 - Recognition of legal acts
 - Enforcement of temporary resolution stays of close-out rights
 - Effects of resolution measures on foreign bank branches and foreign assets
 - Bail-in debt

III. Conclusion

- The potential impediments are identified
- Implementing FSB Key Attributes and proposed directive to overcome the impediments
- A lot has already been done, but a lot still has to be done!



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