



Financial Sector Crisis Management

Proposed Crisis Management Directive versus Existing German Legislation

November 2012

© 2012 Cleary Gottlieb Steen & Hamilton LLP. All rights reserved.

Throughout this presentation, "Cleary Gottlieb" and the "firm" refer to Cleary Gottlieb Steen & Hamilton LLP and its affiliated entities in certain jurisdictions, and the term "offices" includes offices of those affiliated entities.

Table of Contents

- Part 1: Proposed Crisis Management Directive and German Restructuring Act – Overview
 - 1.1 Proposed Crisis Management Directive – Overview
 - 1.2 German Restructuring Act – Overview
 - 1.3 Recent Developments in Germany
- Part 2: Comparison of Proposed Crisis Management Directive and German Restructuring Act
 - 2.1 Scope of Application
 - 2.2 Resolution Authorities
 - 2.3 Recovery and Resolution Plans, Intra-group Financial Support
 - 2.4 Early Intervention Tools
 - 2.5 Resolution Triggers
 - 2.6 Resolution Tools
 - 2.7 Temporary Stay on Obligations and Termination Rights
 - 2.8 Safeguards for Counterparties
 - 2.9 Resolution Funding
- Part 3: Outlook
 - 3.1 Proposed Crisis Management Directive
 - 3.2 German Restructuring Act

Part 1: Proposed Crisis Management Directive and German Restructuring Act – Overview

1.1 Proposed Crisis Management Directive – Overview (1/3)

■ Timetable

- June 6, 2012: European Commission proposal for a directive establishing a framework for the recovery of institutions (*i.e.*, credit institutions and certain investment firms) (“**Crisis Management Directive**” or “**Directive**”)
- Ambitious timing: European Commission aims to complete legislation by ideally December 2012
- Negotiation of compromise text will affect finalization of the Directive and possibly also timetable for transposition
- September 12, 2012: European Commission proposals to create a “banking union” with a “single supervisory authority” will result in significant changes to the proposed Crisis Management Directive, albeit only in a second step (*i.e.*, such changes are supposed to be effected after the Directive’s adoption by the end of 2012)
- October 11, 2012: European Parliament’s Committee on Economic and Monetary Affairs draft report on the Directive sets forth a number of comments and recommendations on the Directive
- November 2, 2012: German bank regulator (*BaFin*) launches a consultation on draft guidelines setting forth “Minimum Requirements for Restructuring Plans” of credit institutions
- January 1, 2015: Transposition deadline (except for bail-in tool)
- January 1, 2018: Transposition deadline for bail-in tool

1.1 Proposed Crisis Management Directive – Overview (2/3)

- Why a Crisis Management Directive?
 - Lessons learnt from the financial crisis
 - Regular insolvency proceedings unsuitable for restructuring or liquidation of failing institutions because lack of trust results in immediate collapse of failing institutions (clients stop doing business with them) and regular insolvency proceedings take too long
 - Failure of a single institution may result in vital banking services becoming unavailable generally
 - Failure of institutions may be contagious
 - Bail-out of institutions with public funds costly and economically inefficient
- What are the main goals of the Crisis Management Directive?
 - Solve the “too-big-to-fail” problem
 - Harmonize EU Member State laws
 - Provide preparatory measures, preventive measures and early intervention means designed to avoid resolution of institutions
 - Provide toolbox for effective resolution of failing institutions without the use of public funds

1.1 Proposed Crisis Management Directive – Overview (3/3)

- What does “resolution” of institutions mean?
 - Comprehensive restructuring of a failing institution (in full or in part)
 - By a government authority vested with resolution powers
 - With a view to ensuring continuity of the institution’s essential functions, preserving financial market stability and restoring viability of the resolved institution (in full or in part)

1.2 German Restructuring Act – Overview (1/3)

- January 1, 2011: Effective date
- Principal areas of regulation comprising the German Restructuring Act (*Restrukturierungsgesetz*, “**German Restructuring Act**”)
 - German Credit Institution Reorganization Act (*Kreditinstitute-Reorganisationsgesetz*, “**German Reorganization Act**”)
 - Amendments to the German Banking Act (*Kreditwesengesetz*, “**German Banking Act**”)
- Why a German Restructuring Act?
 - Lessons learnt from the financial crisis
 - German insolvency and bank supervisory laws inadequate to deal with the failure of market-relevant credit institutions (as defined below), whose failure may affect financial market stability
 - Further use of public funds for restructuring or liquidation of market-relevant credit institutions undesirable
- Main goals of the German Restructuring Act
 - Solve the “too-big-to-fail” problem
 - Provide toolbox for effective resolution of failing market-relevant credit institutions without the use of public funds

1.2 German Restructuring Act – Overview (2/3)

- Four major tools provided by the German Restructuring Act
 - **Early intervention powers** for *BaFin*, such as power to require institutions to increase their own funds and liquidity, prohibit distributions or limit the incurrence of exposures if certain requirements are met
 - Voluntary **restructuring proceedings** pursuant to the German Reorganization Act
 - Application by a credit institution to *BaFin*; application has to include a restructuring plan and a proposal for a restructuring advisor; restructuring plan must not (directly) interfere with the rights of shareholders, creditors and other third parties; restructuring plan may provide for all other measures suitable for a restructuring of the credit institution, such as de-risking, monetizing assets, reducing work force, recapitalization measures (with the consent of shareholders) or obtaining (super-senior) restructuring financing
 - Upon approval of the restructuring plan and restructuring advisor by the Higher Regional Court (*Oberlandesgericht*) in Frankfurt am Main, restructuring proceedings will be instituted by court order; restructuring advisor has to implement the restructuring plan

1.2 German Restructuring Act – Overview (3/3)

- **Reorganization proceedings** pursuant to the German Reorganization Act
 - Upon failure of voluntary restructuring proceedings or if voluntary restructuring proceedings are not viewed as promising by the credit institution, the restructuring advisor or the credit institution, as applicable, may notify *BaFin* with a view to have reorganization proceedings instituted; notification has to include reorganization plan which may curtail the rights of third parties including shareholders
 - Upon receipt of notification, *BaFin* has the right (but not the obligation) to apply for the institution of reorganization proceedings if (i) the credit institution is at imminent risk of failure for insolvency reasons (*Bestandsgefährdung*) and (ii) such risk of failure poses risks to the stability of other enterprises active in the financial sector, the financial market at large, or the general trust of depositors and other market participants in the functioning of the financial system (*Systemgefährdung*) (such a credit institution, a “**market-relevant credit institution**”)
- **Transfer order** pursuant to the German Banking Act
 - If *BaFin* determines that a market-relevant credit institution is at imminent risk of failure in the circumstances described above, *BaFin* may issue a transfer order forcing such credit institution to transfer its market-relevant business to another credit institution (bridge bank), thus allowing for the liquidation of the remaining (not market-relevant) business
- Introduction of the German Bank Restructuring Fund (*Restrukturierungsfonds*) administered by the German Federal Authority for Financial Market Stabilization (*Bundesanstalt für Finanzmarktstabilisierung*, “**Financial Market Stabilization Authority**”) and financed by a bank levy imposed on all German credit institutions

1.3 Recent Developments in Germany

- On November 2, 2012, *BaFin* started a consultation among market participants regarding its draft release on Minimum Requirements for Recovery Plans (*Mindestanforderungen an die Ausgestaltung von Sanierungsplänen*) which deals with the preparation and regular update of recovery plans for credit institutions which are of systemic importance for the German financial market
- Where a relevant credit institution belongs to a regulatory banking group, the German parent credit institution is responsible for preparing the recovery plan, including for the banking group
- The recovery plan requirement is based on the general requirement to establish and maintain an adequate risk management system set forth in Section 25 a of the German Banking Act
- Recovery plans must contain a comprehensive description and analysis of the organizational structure, business model and internal and external interdependencies of the credit institution and group concerned
- Recovery plans must further include a comprehensive set of potential remedies which could be used in a situation of financial distress
- In connection with the establishment and annual update of their recovery plans, relevant credit institutions must perform stress tests involving different stress scenarios and analyze the impact of the stress scenarios on their business
- Recovery plans must identify and describe specific remedies targeted to address certain stress scenarios
- As part of their recovery plan, relevant credit institutions must adopt a crisis-related communication plan

Part 2: Comparison of Proposed Crisis Management Directive and German Restructuring Act

2.1 Scope of Application (1/2)

Proposed Crisis Management Directive

- **EU institutions** (i.e., EU credit institutions and EU investment firms (with certain exceptions) within the meaning of the Capital Requirements Directive), their EU holding companies and, in certain circumstances, EU branches of non-EU institutions
- Group recovery plans and group resolution plans
 - Must cover the entire group **including** non-EU subsidiary institutions
 - To be prepared by (i) the relevant EU entity responsible for compliance with consolidated supervision (in the case of group recovery plans) or (ii) the authority responsible for consolidated supervision (in the case of group resolution plans)
 - In the case of group resolution plans covering entities incorporated in non-EU countries, the plan must describe any arrangements made with the competent non-EU authorities for coordination and cooperation purposes

German Restructuring Act

- **Credit institutions** within the meaning of the German Banking Act (which term includes certain investment firms within the meaning of the Capital Requirements Directive) even if such credit institutions are part of a non-German EU group of institutions
- Restructuring proceedings and reorganization proceedings available only to credit institutions with a legal seat in Germany; proceedings apply on an entity and not on a group level, but reorganization plan may affect rights of the parent company or subsidiaries *vis-à-vis* the credit institution concerned, whether or not the parent company or the subsidiaries are located in Germany or elsewhere

2.1 Scope of Application (2/2)

Proposed Crisis Management Directive

- Proposed Crisis Management Directive not limited to systemically important institutions, but EU Member State resolution authorities may provide for simplified obligations for certain other institutions, taking into account their relevance for financial market stability

German Restructuring Act

- *BaFin* may exercise certain of its early intervention tools and the bridge institution tool (*i.e.*, its power to issue a transfer order as described above) also *vis-à-vis* the parent company of a group of institutions even if not the parent company but another group company or the group as a whole is in trouble, *provided, however*, that such parent company has its seat in Germany

2.2 Resolution Authorities

- **Resolution authorities** are authorities in charge of overseeing institutions for purposes of preparing and implementing recovery and resolution plans
- Resolution authorities may have to prepare resolution plans for the institutions for which they are in charge
- Resolution authorities have the power to deploy early intervention and resolution tools

Proposed Crisis Management Directive

- Establishment of **national resolution authorities**; may be identical with the national supervisory authorities, but separation of supervisory and resolution function required

German Restructuring Act

- **BaFin**; no separation of supervisory and resolution function

2.3 Recovery and Resolution Plans, Intra-group Fin. Support (1/4)

- **Recovery plans:** Contingency plans setting out measures which enable an institution to take early action to restore its long-term viability in a situation of financial distress
- A recovery plan must include certain minimum information and assumptions regarding the deterioration of an institution's financial condition as well as a set of proposed remedies (such as recapitalization measures, de-risking, *etc.*) with which the institution (and not the resolution authority) proposes to restore its financial soundness
- **Resolution plans:** Contingency plans setting out measures for the resolution of an institution in a range of scenarios, including overall financial market instability
- A resolution plan provides for a restructuring of the institution concerned and may, if implemented, directly affect the rights of shareholders and creditors of the institution with the aim to ensure that the institution can be dissolved, if necessary, and its systemically important business can be continued, either as part of the restructured institution or as part of another institution or bridge bank, without interruption and (ideally) without the use of public funds
- Resolution authorities may be vested with the power to order, prior to the crisis of an institution, the removal of impediments to resolution, such as complexity of the institution, *etc.*
- If not already allowed under national legislation, (transposition) legislation may also allow, and remove impediments to, ***intra-group financial support*** aimed at addressing the deteriorating financial condition of an institution

2.3 Recovery and Resolution Plans, Intra-group Fin. Support (2/4)

Proposed Crisis Management Directive

- Institutions required to prepare and update a **recovery plan** at least annually
- Competent resolution authority to prepare a **resolution plan** for each institution for which it is in charge in consultation with the competent supervisory authority
- Power to request from an institution the removal of material impediments to resolution, including limitation of exposures, divestiture of assets, termination of activities or change of legal or operational structures
- **Intra-group financial support** allowed subject to certain conditions, such as approval of the support arrangements by the authority responsible for consolidated supervision, reciprocity of financial support, and absence of any risk that the provision of financial support jeopardizes the liquidity or solvency of the support provider

German Restructuring Act

- So far no explicit statutory requirement for credit institutions to prepare a recovery or resolution plan. On November 2, 2012, *BaFin* started a consultation regarding a draft release on Minimum Requirements for Recovery Plans of credit institutions. Should the release become effective, credit institutions which are systemically important for the German market will be required to prepare a resolution plan and update it at least annually
- **Restructuring plan**
 - A restructuring plan like a recovery plan is aimed at restoring the financial soundness of a credit institution; it is different from a recovery plan, though, because it is not prepared in advance on a regular basis, but only in an acute crisis
 - A restructuring plan can be implemented only within the framework of restructuring proceedings to be instituted by court order (see above)
 - A restructuring plan must not provide for measures affecting creditors' or shareholders' rights

2.3 Recovery and Resolution Plans, Intra-group Fin. Support (3/4)

Proposed Crisis Management Directive

German Restructuring Act

- **Reorganization plan**
 - Like a resolution plan, a reorganization plan provides for all steps necessary to comprehensively restructure a market-relevant credit institution and may provide for curtailing the rights of shareholders and creditors (including a transfer of shares, debt-equity-swaps or reduction of debt)
 - A reorganization plan can be implemented only within the framework of reorganization proceedings to be instituted by court order upon application by *BaFin* (see above)
 - Different from a resolution plan, a reorganization plan is not prepared in advance on a regular basis, but only if a market-relevant credit institution is at imminent risk of failure for insolvency reasons, and a reorganization plan is subject to approval by the shareholders and creditors of the credit institution concerned; in certain circumstances, a reorganization plan may be deemed approved by the shareholders or certain groups of creditors

2.3 Recovery and Resolution Plans, Intra-group Fin. Support (4/4)

Proposed Crisis Management Directive

German Restructuring Act

- Following shareholder and creditor approval and upon confirmation by the competent court, the measures set forth in a reorganization plan take effect automatically without any further implementation
- ***Intra-group financial support***
 - No specific provisions on ***intra-group financial support*** under German law
 - German parent companies of groups of institutions typically provide financial support to their subsidiaries by way of support undertakings (*Patronatserklärungen*), and there are (generally) no limitations on granting such down-stream financial support
 - Upstream and cross-stream financial support by German subsidiary institutions is subject to general corporate law restrictions

2.4 Early Intervention Tools (1/2)

- **Early intervention tools:** Powers of the resolution authorities to intervene at an early stage in the event of the deterioration of the financial condition of an institution
- Early intervention tools range from an order to implement a recovery plan to the appointment of a special manager or representative

Proposed Crisis Management Directive

- Power to order, *inter alia*:
 - The implementation of one or more of the arrangements and measures set out in an institution's recovery plan
 - The preparation of an **action program** to overcome the financial problems of the institution, *e.g.*, a description of the envisaged implementation of the measures set out in the recovery plan
 - The preparation of a **debt restructuring plan**

German Restructuring Act

- *BaFin* may request that an institution take measures to improve its own funds or liquidity situation if the institution is likely unable to meet own funds or liquidity requirements on an ongoing basis. For example, *BaFin* may request:
 - Reasoned projections for the development of the institution's business in the next three years
 - An evaluation of, and report on, steps to better protect against, or reduce, the institution's risk exposures

2.4 Early Intervention Tools (2/2)

Proposed Crisis Management Directive

- An **action program** and a **debt restructuring plan**
 - Will have to be prepared and implemented by the institution concerned if so ordered by the resolution authority in a situation of acute financial problems
 - May interfere with the rights of the institution's shareholders and creditors only with their consent
 - Are fundamentally different from a resolution plan
- Appointment of a **special manager** to replace the institution's management for generally not more than one year to restore a sound financial condition of the institution by, e.g., implementing capital measures, reorganizing the ownership structure of the institution or preparing it for resolution

German Restructuring Act

- Measures to improve the institution's capital position
- If an institution does not meet own funds or liquidity requirements, *BaFin* may take further steps, such as prohibiting distributions to shareholders, limiting the incurrence of exposures, or requesting the reduction of existing exposures or the preparation and implementation of a **recovery plan** (to be distinguished from a restructuring plan in restructuring proceedings or a reorganization plan in reorganization proceedings)
- Appointment of a special representative who, *inter alia*, may take over management functions, develop a restructuring plan, or take appropriate measures in a situation where the institution is likely to default on its debt

2.5 Resolution Triggers

Proposed Crisis Management Directive

- An institution is failing or likely to fail in certain circumstances, such as, most importantly:
 - Actual or imminent overindebtedness
 - Actual or imminent illiquidity
 - Actual or imminent breach of regulatory capital requirements to an extent that would justify the withdrawal of the institution's license
 - The institution requires state aid other than certain limited guarantees
- No alternative private sector or supervisory action would prevent the institution's failure and the resolution is in the public interest

German Restructuring Act

- A credit institution is at imminent risk of failure for insolvency reasons (which risk is deemed to exist if the credit institution's own funds or liquidity have fallen below 90 *per cent.* of the statutory minimum ratios on a stand-alone or consolidated basis) (*Bestandsgefährdung*); and
- Such risk of failure poses risks to the stability of other enterprises active in the financial sector, the financial market at large, or the general trust of depositors and other market participants in the functioning of the financial system (*Systemgefährdung*)

2.6 Resolution Tools (1/2)

Tool	Proposed Crisis Management Directive	German Restructuring Act
<i>Sale of business tool</i>	Yes – power to sell the shares in, or all or part of the assets and liabilities of, the institution to a purchaser for adequate consideration	Yes – power to transfer all or part of the market-relevant credit institution’s assets and liabilities (but not the shares in the institution) to a transferee for adequate consideration (shares of the transferee entity or cash)
<i>Bridge institution tool</i>	Yes – power to transfer all or part of the institution’s assets and liabilities to a government-owned bridge institution	Yes – power to transfer all or part of the market-relevant credit institution’s assets and liabilities to a bridge institution (in which the German Bank Restructuring Fund may own shares) for adequate consideration
<i>Asset separation tool</i>	Yes – power to transfer certain impaired or problem assets of an institution to a government-owned asset management vehicle for adequate consideration (tool to be used only in conjunction with another resolution tool)	No – under the German Restructuring Act, <i>BaFin</i> is not entitled to transfer impaired or problem assets only However, pursuant to the German Second Financial Market Stabilization Act (2. <i>Finanzmarktstabilisierungsgesetz</i>) until December 31, 2012, credit institutions and financial holding companies may apply to the Financial Market Stabilization Authority for the transfer of certain problem assets and liabilities to “bad banks” established by the Financial Market Stabilization Authority

2.6 Resolution Tools (2/2)

Tool	Proposed Crisis Management Directive	German Restructuring Act
<i>Bail-in tool</i>	<p>Yes – power to write down or convert, in conjunction with a business reorganization plan, debt with the following exceptions:</p> <ul style="list-style-type: none"> ▪ Deposits guaranteed in accordance with the Deposit Guarantee Schemes Directive ▪ Secured liabilities up to the value of the collateral ▪ Liabilities resulting from holding client assets ▪ Liabilities with an original maturity of less than one month ▪ Liabilities to employees, commercial or trade creditors ▪ Liabilities to tax and social security authorities (if preferred under national insolvency law) ▪ (In certain circumstances) derivative claims 	<p>No – <i>BaFin</i> has no power to write down or convert debt</p> <p>However, as described above, a market-relevant credit institution may initiate reorganization proceedings resulting in a reorganization plan providing for a debt write-down or conversion of debt into equity if such plan is approved by the required majorities of shareholders and creditors and if certain additional requirements are met; claims of employees for salary and pension payments or payment claims of bank customers covered by statutory or voluntary deposit guarantee schemes are not subject to restructuring through a reorganization plan</p>

2.7 Temporary Stay on Obligations and Termination Rights (1/2)

- The successful use of resolution tools may be jeopardized if a counterparty exercises termination or similar rights under contractual arrangements with the resolved institution prior to, or as a consequence of, the implementation of a resolution tool where these contractual arrangements are necessary or useful for the continuation of the institution, or parts thereof, as a going concern
- Thus, a **temporary stay on obligations and counterparty termination rights** is necessary to ensure the successful implementation of resolution tools

Proposed Crisis Management Directive

- Pending the assessment of resolution tools and identification of assets to be transferred resolution authorities may impose a **temporary stay** until 5pm the business day following publication by the resolution authority of the resolution action taken on:
 - Any contractual payment or delivery obligations of an institution (other than those relating to eligible deposits under the Deposit Guarantee Schemes Directive)

German Restructuring Act

- **No specific right** to impose a temporary stay on contractual payment or delivery obligations of a credit institution pending the assessment of a proposed restructuring, but general power to impose a moratorium if a credit institution is likely to default on its payment obligations
- In case of a transfer order *vis-à-vis* a market-relevant credit institution, counterparties (or the transferee entity) **may not accelerate or otherwise terminate** any transferred contracts with such credit institution solely by reason of the (imminent) transfer; contractual clauses providing for a termination right in such scenario are unenforceable

2.7 Temporary Stay on Obligations and Termination Rights (2/2)

Proposed Crisis Management Directive

- Any counterparty termination rights under financial contracts (i.e., securities contracts (such as contracts for the purchase, sale or loan of a security or options on securities), commodities contracts (such as forward contracts or options on commodities), futures and forwards contracts, repos and swap agreements)
- A transfer of a financial contract to a transferee entity or the application of other resolution tools does not give counterparties of the institution concerned the right to accelerate or otherwise terminate financial contracts with such institution unless there is a subsequent default; contractual clauses providing for a termination right in such scenario are unenforceable

German Restructuring Act

- Following the initiation of reorganization proceedings with respect to a market-relevant credit institution by notifying *BaFin*, any termination of contracts (whether automatic or by notice and irrespective of the kind of default) with the institution is ineffective until the next business day, and contractual clauses providing for a termination right in such scenario are unenforceable

2.8 Safeguards for Counterparties

- Given that resolution tools may affect the rights of counterparties, legislation may provide for **safeguards** for the benefit of counterparties of an institution in order to prevent cherry-picking by resolution authorities and to minimize detrimental effects on affected counterparties

Proposed Crisis Management Directive

- Resolution must not result, to the extent possible, in a less favorable treatment of creditors than in the event of liquidation in insolvency
- In case of the bail-in tool, creditors of the same class enjoy equal treatment
- Separate transfers of liabilities, rights and contracts which are part of netting arrangements, collateral arrangements, structured finance arrangements or similar arrangements are not permissible

German Restructuring Act

- In case of a transfer order, the transferor credit institution remains liable for any transferred liabilities up to the amount recoverable upon liquidation in insolvency
- A transferor credit institution is entitled to adequate consideration for transferred assets
- Separate transfers of liabilities, rights and contracts which are part of netting arrangements recognized for bank regulatory purposes or financial collateral arrangements are not permissible

2.9 Resolution Funding (1/2)

- One of the goals of crisis management or resolution legislation is to **avoid or minimize the use of public funds** for rescue measures for failing institutions
- However, in particular systemically important parts of a failing institution may require funding
- **Funding options** may range from the institutions' obligation to maintain a certain level of unsecured debt available for recapitalization to the establishment of bank restructuring funds funded by contributions of institutions

Proposed Crisis Management Directive

- Establishment of a “**European System of Financing Arrangements**” comprised of national financing arrangements which will be mutualized in certain circumstances
- National financing arrangements have to be pre-funded
 - The funding requirements of each national financing arrangement have to be calculated based on the amount of total deposits covered by the Deposit Guarantee Schemes Directive (*i.e.*, not necessarily on the basis of any potentially higher voluntary deposit guarantee schemes)

German Restructuring Act

- **German Bank Restructuring Fund** administered by the Financial Market Stabilization Authority
- Pre-funded, financed by a bank levy on credit institutions
 - Annual and special contributions
 - Amount of annual contributions to be calculated based on the credit institutions' size and interconnectedness in the financial market
 - Total contributions are intended to cover the costs of any measures of the German Bank Restructuring Fund

2.9 Resolution Funding (2/2)

Proposed Crisis Management Directive

- Minimum funding level of national financing arrangement not less than 1 *per cent.* of total covered deposits to be accumulated within ten years from the effective date of the Crisis Management Directive
- Special contributions possible
- Deposit guarantee schemes will have to contribute to the funding of resolution measures up to the amount for which they would have been liable if the institution had been wound up in insolvency
- Institutions (or groups of institutions) must maintain a “sufficient” minimum of liabilities eligible for debt write-down, taking into account, *inter alia*, the institutions’ resolvability, their size, business model and risk profile, and the extent to which the failure of the institution concerned could have an adverse impact on financial market stability

German Restructuring Act

Part 3: Outlook

3.1 Proposed Crisis Management Directive (1/2)

- The proposed Crisis Management Directive comprises a comprehensive set of rules aimed at minimizing the risk of failure of institutions and, if a failure cannot be avoided, facilitating the restructuring and dissolution of institutions without the use of public funds, resting on basically four pillars:
 - Institutions are required to prepare **recovery plans** which, if implemented, shall allow the institution to restore its financial soundness in a situation of financial distress
 - Resolution authorities must prepare **resolution plans** providing for the restructuring of an institution should its recovery plan fail
 - **Resolution authorities** are vested with **powers** to remove impediments to resolvability, to intervene early in an institution's crisis, and to implement a restructuring (whether or not in accordance with a resolution plan) if necessary, including using resolution tools, such as the bail-in tool
 - Establishment of a **scheme of national financing arrangements** funded by contributions of the institutions and designated for funding resolutions; arrangements will be mutualized in certain circumstances
- Appropriate mechanisms to deal with groups of institutions consisting of several multinational institutions (possibly also including entities active in the financial sector which are conducting non-banking business such as insurance companies) will be key to future resolution of groups of institutions

3.1 Proposed Crisis Management Directive (2/2)

- Resolution of international groups of institutions raises questions, such as how resolution can be implemented in all jurisdictions concerned (*i.e.*, including in jurisdictions other than the jurisdiction of the competent resolution authority), in particular how a bail-in of creditors of international groups of institutions might work
- Restructuring large, complex (international) institutions in the short time available (until 5pm the business day following publication by the resolution authority of the resolution action taken) seems particularly challenging
- Cross-border recognition of resolution actions affecting assets and liabilities in non-EU countries as well as close cooperation of EU and non-EU resolution and supervisory authorities will be key to any successful resolution of a failing multi-national institution (or group of institutions)
- While the proposed Crisis Management Directive marks a step forward to solving the “too-big-to-fail” problem, it can be expected that the further legislative process regarding the proposed Crisis Management Directive will likely take some time, in particular in light of the wider objective of creating a “banking union” in Europe to complement the European Monetary Union

3.2 German Restructuring Act

- In Germany, substantial amendments to the existing legislation will be required to transpose the proposed Crisis Management Directive:
 - While *BaFin* has ***certain early intervention powers*** and the (creditor-dominated) ***reorganization proceeding*** as well as *BaFin*'s power to issue transfer orders allow a restructuring of failing market-relevant credit institutions, there is no equivalent to the comprehensive resolution tools provided in the proposed Crisis Management Directive
 - Reorganization plans are ***available only to market-relevant credit institutions*** and not to all types of institutions covered by the proposed Crisis Management Directive
 - ***Reorganization plans*** require, generally, the approval of shareholders and creditors of the market-relevant credit institution concerned, which is not comparable to the bail-in tool provided for in the proposed Crisis Management Directive
 - Unlike the proposed Crisis Management Directive, the German Restructuring Act ***does not provide for recovery or resolution plans***
 - The German system of resolution funding by the ***German Bank Restructuring Fund*** would need to be amended, in particular because contributions are levied only on credit institutions and are calculated on the basis of the credit institutions' size and interconnectedness in the financial market rather than the amount of covered deposits



NEW YORK
WASHINGTON
PARIS
BRUSSELS
LONDON
MOSCOW
FRANKFURT
COLOGNE
ROME
MILAN
HONG KONG
BEIJING
BUENOS AIRES
SÃO PAULO
ABU DHABI
SEOUL

CLEARY GOTTlieb STEEN & HAMILTON LLP

www.clearygottlieb.com