Banking Newsletter

Banking Recovery and Resolution Directive

11 August 2015

General

The financial crisis has shown that there is a significant lack of adequate tools at a European Union level to deal effectively with unsound or failing credit institutions and investment firms that often have cross-border presence. The Bank Recovery and Resolution Directive 2014/59/EU ("**BRRD**") provides the national authorities of Member-States with common powers and tools that will prevent insolvency or, when insolvency occurs, will minimise the negative repercussions by preserving the systematically important functions of the institutions concerned.

On 23 July 2015, the BRRD was transposed into Greek law and came into force by virtue of Law 4335/2015. Said law was enacted in the course of implementing the prerequisite reforms package -reflected in the Euro Summit Statement of 12 July 2015[1]- with the purpose of requesting a new financial assistance programme by the European Stability Mechanism ("**ESM**").

The BRRD is part of the Single Rulebook[2] governing the EU financial services market and establishes a reference framework for the recovery and resolution of credit institutions and investment firms. Its transposition into Greek law is therefore expected to be of particular significance, as the Greek banking sector is currently facing a severe crisis and several alternatives are being discussed in order to avoid potential failures (especially as far as the four Greek systemic banks are concerned).

Deviations from BRRD

As a general comment, the provisions of Law 4335/2015 do not substantially deviate from the respective provisions of the BRRD. In this respect, it fully adopts the measures and procedures for the three stages of recovery under the BRRD, namely the stages of preparation, early intervention and resolution.

[1] See Euro Summit Statement dated 12 July 2015

[2] The EU Single Rulebook consists in particular of EU Regulation 575/2013 ("Capital Requirements Regulation" or "CRR"), Directive 2013/36/EU ("Capital Requirements Directive IV" or "CRD IV"), the BRRD and Directive 2014/49/EU ("Deposit Guarantee Schemes Directive" or "DGSD") and sets a uniform regulatory framework for credit and financial institutions operating in the EU for the purpose of completing the single market in financial services.

Amongst the deviations, we would like to highlight the competencies of the Ministry of Finance ("**MoF**") and the fact that the provisions of Law 4335/2015 pertaining to the exercise of the bail-in tool, along with the powers of write down and conversion associated with such tool, will be applicable in Greece only from 1 January 2016[3].

Resolution measures

Law 4335/2015 introduces into Greek law a toolkit of the four resolution measures that may be used for the purposes of assisting the recovery of a supervised institution in distress. More specifically, these measures are the following:

1. sale of business tool
2. bridge institution tool
3. asset separation tool and
4. bail-in tool.

The application of the above measures is subject to certain conditions and requirements whereas, for the purposes of selecting the appropriate tool, the national resolution authorities should take a wide range of factors into consideration (e.g. the feasibility and the credibility of the institution in resolution).

Designation of National Resolution Authorities and Funds

The national resolution authorities designated by virtue of Law 4335/2015 are the Bank of Greece with respect to credit institutions and the Hellenic Capital Market Commission with respect to investment firms.

The Resolution Scheme of the Hellenic Deposit and Investment Guarantee Fund ("**HDIGF**") is designated as the national resolution fund for ensuring the effective implementation of the resolution tools in respect of credit institutions. As far as investment firms are concerned, the respective functions are performed by the Athens Stock Exchange Members' Guarantee Fund.

The national resolution authorities are granted with a wide range of resolution powers, including the power to request from all supervised institutions any available information, to carry out dawn raids and to impose fines and administrative sanctions. In discharging their duties, the national resolution authorities will further work in close cooperation with their counterparts at EU-level, namely the Single Recovery Mechanism and the Single Recovery Fund.

In deviation from the provisions of BRRD, the consent of the MoF is required for the exercise of various powers delegated to the national resolution authorities (including

[3] See also Opinion of the European Central Bank dated 20 July 2015

giving effect to the bail-in tool). The consent requirement raises the question whether MoF is also a resolution authority alongside the Bank of Greece and the Hellenic Capital Market Commission.

The bail-in tool

The provisions of Law 4335/2015 pertaining to the exercise of the bail-in tool (including the powers of write down and conversion) will come into effect on 1 January 2016.

In view of the much anticipated recapitalisation of the Greek banks, the bail-in tool of the BRRD has attracted particular attention. In brief, use of such tool in the context of a potential recapitalisation of a credit institution or investment firm means that financial assistance will be drawn from the national resolution fund for restructuring the liabilities of such institution or firm.

Pursuant to Article 44 of Law 4335/2015, applying the bail-in tool to draw funds from the HDIGF in favour of a Greek bank requires that:

a) a contribution to loss absorption amounting to at least 8% of the total liabilities of the bank (including own funds) is made by common shareholders, holders of other instruments of ownership, holders of capital instruments and holders of other eligible liabilities and takes effect through write down, conversion or otherwise and
b) the contribution of the HDIGF does not exceed 5% of the total liabilities of the bank (including own funds).

Deposits in the credit institutions that undergo a recapitalisation procedure are guaranteed up to Euro 100,000; under exceptional circumstances, uninsured (eligible) deposits held by natural persons or small and medium size enterprises might be excluded in whole or in part from the application of write-down or conversion powers.

To be noted that, in respect of creditors' rights, the write down in the context of loss absorption deviates from the ordinary ranking of creditors stipulated in Articles 153-156 of the Greek Bankruptcy Code.

[4] See also ESM Guideline on Financial Assistance for the Direct Recapitalisation of Institutions dated 8 December 2014

[5] See also ESM Guideline on Financial Assistance for the Recapitalization of Institutions (for indirect bank recapitalization in combination with Article 15 of the ESM Treaty)

Recapitalisation of Greek Banks before the end of 2015

In view of the fact that the applicability of the bail-in tool starts after 1 January 2016, the upcoming recapitalisation of Greek banks before such date may be effected either through the ESM directly (ESM direct recapitalisation instrument[4]) or through funds of the Hellenic Financial Stability Fund ("HFSF") received by the ESM (ESM indirect recapitalisation instrument)[5].

As a general remark and as of today, the timeframe of the recapitalisation procedure provides that the stress tests -including audits of the loan portfolios of the credit institutions-- would be performed within August 2015; the stress test results are then expected before November 2015 so as to allow the recapitalisation procedure to start within the same month.

a. The ESM direct recapitalisation instrument

Article 8 of the ESM Guideline on Financial Assistance for the Direct Recapitalisation of Institutions (8 December 2014) provides for an interim bail-in procedure until the full implementation of the BRRD bail-in tool in all Member States. In particular, the bail-in condition for the direct participation of the ESM in the recapitalisation of a bank until 31 December 2015 requires that:

a) a contribution to loss absorption amounting to 8% of the total liabilities of the bank (including own funds) is made by common shareholders, holders of other instruments of ownership, holders of capital instruments and holders of other eligible liabilities and takes effect through write down, conversion or otherwise and
b) HDIGF should contribute to the recapitalisation up to the 2015 target level.

In this respect, the ESM bail-in condition is quite similar to that of the BRRD mechanism. After 1 January 2016, the ESM conditions will be those provided in the BRRD.

b. The HFSF framework

Law 3864/2010, as amended (the HFSF Law), governs the recapitalisation procedure of credit institutions through the HFSF. Pursuant to such provisions and unlike the BRRD, no minimum loss absorption thresholds are foreseen and no bail-in of any uninsured deposits (i.e. deposits over Euro 100,000) is required for the HFSF to participate in the recapitalisation procedure.

Law 3864/2010 requires that certain classes of investors must be bailed-in prior to any involvement of the HFSF by a priority order which has as follows: those in possession of common equity, if necessary, those in possession of preferred equity or

of debt qualifying as own capital of Tier 1 and lastly those in possession of subordinated debt.

A crucial issue is that to the extent HFSF's recapitalisation funds derive from state resources, state aid implications arise.

Post Scriptum

The method that will be procured for the upcoming recapitalisation of the Greek banks will have different repercussions not only for the recapitalised institutions themselves, but also for the Greek economy in general. The three distinct options mentioned above [i.e. recapitalisation under (1) the BRRD, (2) the HFSF Law or (3) the ESM directly] require not only different timetables and different classes of investors to be bailed in, but also have a different effect on the ultimate burden between EU member states. The BRRD and ESM are designed for the allocation of systemic damages between member states, whereas the recapitalisation under the HFSF Law will ultimately shift the burden to Greek taxpayers. This seems contradictory with the rationale of the BRRD.

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