

Financial Stabilisation Measures for Endangered Germany-Based Credit Institutions



The German Federal Government has implemented measures for the financial industry on the basis of the Financial Markets Stabilisation Act. For long-term stabilisation, it has introduced measures that place emphasis on the restructuring and reorganisation of German financial institutions, including the establishment of a restructuring fund.

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The financial crisis has faced the worldwide capital market with new challenges. Banks worldwide have applied for insolvency and states have implemented numerous financial stabilisation measures. In Germany, the Federal Government has implemented a rescue package for the financial industry on the basis of the Financial Markets Stabilisation Act (*Finanzmarktstabilisierungsgesetz*). In addition thereto, the government draft aims at implementing further, long-term stabilisation measures with emphasis on the restructuring and reorganisation of German financial institutions.

On 25 August 2010, the Federal Government (*Bundesregierung*) published a government draft of the Act for the Restructuring and Orderly Liquidation of Credit Institutions for the Establishment of a Restructuring Fund for Credit Institutions and for the Extension of the Limitation Period of Corporate Law Management Liability (Restructuring Act) (*Regierungsentwurf eines Gesetzes zur Restrukturierung und geordneten Abwicklung von Kreditinstituten, zur Errichtung*

eines Restrukturierungsfonds für Kreditinstitute und zur Verlängerung der Verjährungsfrist der aktienrechtlichen Organhaftung [Restrukturierungsgesetz]). Furthermore, a restructuring fund in the form of a bank levy (*Bankenabgabe*) will be introduced in order to involve the financial sector to the rescue costs of future crises.

Key Points of the Government Draft

The government draft provides primarily new pre-insolvency measures aiming to prevent insolvency through the restructuring or reorganisation of endangered banks, in Germany, as contemplated in the Key Points on Financial Markets Regulation (*Eckpunkte zur Finanzmarktregulierung*) of the German Federal Cabinet, issued on 31 March 2010. The restructuring procedures take place with regard to financial institutions that are facing an insolvency risk but where the crisis appears to be manageable. Furthermore, in the case of serious, existence-destructive financial problems, the reorganisation procedures will be applicable. Ultimately, the Restructuring Act introduces measures that obligate banks to transfer all or part of their assets to another bank by order of Germany's Federal

Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*, or the BaFin) if the bank's existence is endangered and the result of its closing would pose a potential systemic risk to the financial system.

The second main proposal of the government draft refers to the introduction of a restructuring fund managed by the Federal Authority for Financial Market Stabilisation (*Bundesanstalt für Finanzmarktstabilisierung*, or FMSA). Under the new rules the banks are forced to affect a bank levy whereby the respective amount must be calculated in relation to the systemic risk of the bank's failure. Beyond this, the government draft introduces an extension of the liability of the management board and its members by expanding the limitation period.

New Bank Reorganisation Act

The Restructuring Act introduces in the new Bank Reorganisation Act (*Gesetz zur Reorganisation von Kreditinstituten*) three different measures for restructuring:

1. voluntary restructuring proceedings (*Restrukturierungsverfahren*) where a restructuring adviser (*Sanierungsberater*) will be appointed and a restructuring plan will be implemented in consultation with the BaFin (Art 1, ss 2–6);
2. reorganisation procedures (*Reorganisationsverfahren*) are initiated by the BaFin in cases where restructuring measures cannot be implemented successfully (Art 1, ss 7–23); and
3. a transfer order (*Übertragungsorder*) must be issued by the BaFin forcing the bank to transfer all or part of its business to a public or private bank, if the BaFin decides that the bank's existence is endangered which might cause a systemic risk for the financial system (Art 2, ss 48a–48s of the draft German Banking Act).

Restructuring

As stated above, restructuring procedures can be initiated by the financial institution itself if it estimates that there is a need for restructuring. However, if financial stabilisation measures are needed and the bank does not initiate the respective procedures, the BaFin can threaten the bank with certain supervisory measures (in particular, prohibit distribution of profits, order the bank to reduce risk positions or dismiss managers).

If the financial institution decides to apply for restructuring procedures, it must submit a restructuring plan that contains appropriate

restructuring measures and the nomination of a restructuring adviser. The BaFin must examine the restructuring plan and if it accepts the proposed measures, the BaFin will file for the opening of restructuring proceedings with the Higher Regional Court (*Oberlandesgericht*). The court must approve the implementation of restructuring procedures and appoint a restructuring adviser. The restructuring adviser is in charge of the implementation of the restructuring plan in close cooperation with the BaFin.

In addition, the BaFin is entitled to issue further measures in the context of restructuring (eg, dismissal of managers, changes of the remuneration and bonus payment systems of the bank or the appointment of a restructuring adviser to the board) where such measures are necessary to protect the interests of creditors.

Reorganisation

Reorganisation procedures are initiated where the restructuring measures cannot be implemented successfully or in cases where restructuring procedures seem to fail. In such cases, the BaFin is entitled to apply for the initiation of the reorganisation procedures with the competent court.

First, the bank must submit a reorganisation plan



to the BaFin. The content of such a reorganisation plan is very similar to an insolvency plan under the German Insolvency Act (*Insolvenzordnung*). The reorganisation plan must contain the reorganisation measures that will apply including:

- capital measures like the reduction or the increase of capital;
- corporate measures like spin-offs of determined business parts;
- the limitations of creditors' rights; and
- debt-equity swaps.

The reorganisation procedures will be implemented after the competent court has heard the respective financial institution, the BaFin and the Deutsche Bundesbank, and has approved the respective reorganisation procedures.

Transfer Order

Ultimately, if the BaFin decides that the bank's existence is endangered, the BaFin is entitled to issue a transfer order. As result of such an order, the financial institution will be forced to transfer all or part of its assets to another entity. However, a transfer order can only become relevant when the financial institution is endangered in its existence

(*Bestandsgefährdung*) and the result of its closing would mean a risk for the stability of the whole financial system (*Systemgefährdung*).

Another condition for a transfer order is that there are no other, less harmful means to reorganise the financial institution. In particular, the BaFin must set a deadline for the credit institution to present a recovery plan (*Wiederherstellungsplan*) to solve the crisis before the implementation of the transfer order as a potential last resort to solve the crisis. Furthermore, the shareholders might be able to add further capital in accordance with a capital increase or other measures that could change the financial situation of the bank. If the bank has already initiated restructuring or reorganisation procedures, the BaFin must prove that the plan is sufficient to solve the crisis. Therefore, the reorganisation plan can also be regarded as a recovery plan.

A precondition for the transfer order is the notarised consent of the adopting entity. Furthermore, it will be inevitable that the adopting entity is located in Germany, has two trustworthy and qualified managers and is sufficiently capitalised. The transfer order will be effective as of the date of its notification to the financial institution and the adopting entity. In the following period, all assets and liabilities are transferred to the adopting entity. The endangered bank will receive a contribution in equity from the adopting entity if the value of the transferred assets exceeds the liabilities.

Under the Restructuring Act, the BaFin has extensive rights against the adopting entity in order to safeguard the transferred assets or business units. Generally, the transfer order is supposed to enable the BaFin to separate the endangered part of the business from the rest of the business in order to restructure the relevant business part. The restructuring of the systemically risky part of the banking business can take place without the involvement of the shareholders of the financial institution. Moreover, the insolvency risk of the endangered bank can be avoided.

Restructuring Fund

A restructuring fund which will be administered by the FMSA based on the Act for the Establishment of a Restructuring Fund for Credit Institutions (*Gesetz zur Errichtung eines Restrukturierungsfonds für Kreditinstitute*) will be established under the Restructuring Act. The restructuring fund will be financed through a bank levy in which all German credit institutions have to pay an annual contribution. The specific amount of the annual contributions will be calculated in relation to the systemic risk of the bank's failure.



The obligation is limited to credit institutions that are listed in section 1, clause 1 of the German Banking Act (*Kreditwesengesetz*) and not to financial institutions (*Finanzdienstleistungsinstitute*) pursuant to section 1, clause 1a of the German Banking Act. The amount of the annual contributions will be calculated based on figures from the bank's most recent financial statements, in particular the subscription relevant liabilities and the nominal value of the bank's off-balance sheet derivative transactions. The credit institution is obliged to pay a minimum contribution as a percentage of the regular contribution even if it did not make any profit at all. The fund is used for restructuring measures in future crises which are decided by the FMSA and the BaFin.

Extension of the Limitation Period of the Management Liability

The Restructuring Act introduces an extension of the limitation period for the liability of the management board members of Germany-based

credit institutions (*Vorstände and Aufsichsräte*) from five years to a maximum of 10 years.

Limitation of Termination Rights

The Restructuring Act also regulates the limitation of the rights of counterparties to terminate contractual relationships with financial institutions entering into reorganisation proceedings or receiving a transfer order from the BaFin.

The underlying agreements with the financial institutions cannot be terminated until the day following the publication of the reorganisation plan. The consequences of such limitations of termination rights have been controversially discussed.

Further Steps

According to the government draft, the proposed implementation date for the Restructuring Act is 31 December 2010. However, whether this date can be achieved mainly depends on the legislative process in the forthcoming months.