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New law 4021/2011: Bridge bank and other preventive and resolution measures for Greek banks

Introduction

On 28 September the Greek Parliament approved a much-discussed law (**Law 4021**), which, among others, amended various provisions of the legal rules affecting Greek banks and the Greek financial market; some of the major changes effected pursuant to it are the addition of a Restructuring Scheme to the existing deposits guarantee scheme, the extension of the provisions of Directive 2002/47/EC on financial collateral arrangements to claims arising from bank lending, the amendment of the procedures for the bankruptcy (special liquidation) of banks and amendments to the law for the establishment of the Hellenic Financial Stability Fund. In this newsletter we have focused on those provisions of Law 4021 that introduce new measures for the resolution of Greek banks, coupled by enhanced supervisory authorities of the Bank of Greece (BoG).

According to the editors of Law 4021 the scope of introducing the respective provisions is the "effective guarantee of financial stability against systemic risks and the active protection of the public's trust in the domestic financial system". The drafters of Law 4021 took into consideration similar legislative initiatives adopted by other member states, such as the UK, Germany, Holland and Ireland, as well as the EC consultation paper published in January 2011 on the Technical Details of a Possible EU Framework for Bank Recovery and Resolution (the **EU Consultation Paper**).

Preventive and resolution measures

Below is a discretionary categorisation of the measures introduced, enhanced or amended by Law 4021 to address limited liquidity and/or failing capital adequacy of Greek banks:

1. Preventive measures

a. setting of higher minimum capital adequacy requirements;

b. restriction on dividends distribution and/or increase reserves and/or reduction of management's fees;

c. request by the BoG for an increase of the bank's share capital;

d. establishment of a recovery plan by the bank;

e. appointment of a supervisor; and

f. suspension of certain obligations of the bank.

2. **Resolution tools**

   a. mandatory partial transfer of assets to third parties; and

   b. establishment of a bridge bank and mandatory transfer of assets and liabilities from the troubled bank to the bridge bank.

Triggering events for the implementation and preventive and resolution measures

The BoG may impose any of the measures listed on the previous section at its discretion, taking into consideration the following:

a. the bank's anticipated lack of ability to recuperate;

b. the bank's lack of ability to implement within a suitable timeframe alternative measures to prevent its failure;

c. the effects that a bank's failure may bring about and especially the volume of deposits, the type and extent of obligations the bank may have towards entities of the financial industry, as well as the participations that the bank may have in entities of the financial industry; and

d. the principle that losses from the bank's failure should be primarily absorbed by its shareholders.

Counterparties' safeguards

According to Law 4021 the implementation of any of the preventive or resolution measures does not trigger the depositors' and investment services clients' protections set out in law 3746/2009 for the Establishment of the Hellenic Deposits and Investment Services Guarantee Fund (HDISGF).

More importantly, Law 4021 expressly provides that, subject to special provisions, the implementation of any of the measures foreseen by it does not constitute a credit event; however, this stipulation may be irrelevant for obligations that are not governed by Greek law.

Higher minimum capital adequacy requirements

Law 4021 makes reference to the BoG's right to set higher (than the minima required under law) capital adequacy ratios in two sections of the same article, namely in paragraph 2a, where the discretion is introduced with no qualitative or quantitative restrictions, and in paragraphs 3 and 4, where the law sets the framework for assessment of the requirement for increased capital on the basis of the quality and effectiveness of corporate governance, internal controls and risk allocation systems of a bank.

It is therefore unclear whether the BoG has blanket discretion to impose higher ratios or whether it may exercise such discretion only if any of the events described in paragraphs 3 and 4 occur (the latter interpretation being in line with the maximum harmonisation approach the EC is favouring for the implementation of the CRD IV rules on capital adequacy ratios).

Share capital increase

The BoG is entitled to request from a bank to raise new equity under terms and conditions set out at the discretion of the BoG, which may include the issuance of preference shares, and the requirement to reduce capital simultaneously with the issuance of new shares.

In addition to the above, the BoG may request a bank to increase its share capital when a supervisor has been appointed to it; the bank's existing shareholders are not entitled to participate in such capital increase.

Appointment of a supervisor

The BoG will be entitled to appoint a supervisor in any of the following cases:

- the bank does not have adequate own funds or is unable to increase its regulatory capital;
- the bank obstructs the BoG from exercising its supervisory controls on the bank;
- the bank is in breach of material legal obligations on a recurrent or continuous

basis or, according to the BoG's assessment, it does not exercise prudent management; and

- upon request by a bank.

In addition, the BoG will be required to appoint a supervisor (i.e. there is no discretion) if;

- the bank has not implemented the Recovery Plan or the Restructuring Plan, as the case may be, or has failed to take similar measures that were agreed with the BoG;

- the bank has not complied with the BoG's request to increase its regulatory funds; and

- the bank has not complied with the BoG's request to transfer part of its assets to third parties or to a bridge bank set up for such purpose.

The supervisor is appointed for a maximum period of 12 months, extendable by a further 18 months. Its authority ranges from veto rights (and co-signing of all management acts) to full substitution of the bank's management, depending on the bank's current state of affairs and quality of its management team. The supervisor's duties are the assessment of the bank's financial situation and prospects of recovery and the submission of proposals for the implementation of recovery or liquidation measures, as the case may be.

Finally, in case of appointment of a supervisor, the BoG may seal offices of the bank for audit purposes.

Suspension of certain obligations

The BoG may suspend certain obligations of a bank, where:

- the BoG has appointed a supervisor to such bank; and

- the bank has very limited liquidity and its regulatory capital is expected to fall below the minimum thresholds.

Suspension may be imposed for a maximum of thirty (30) business days.

The suspension does not affect capital and money market transactions, interbank lending and transactions settled through a clearing system.

Transfer of assets and obligations to third parties

The BoG may instruct a bank to transfer all or part of its assets and/or obligations, following a closed tender process, where the BoG invites those banks and other parties it considers eligible, to bid for the purchase of such assets and liabilities.

Deposits up to €100,000 per depositor and investment services clients' claims up to €20,000, as well as deposits by the Greek State and central government entities are mandatorily included in the transferable liabilities; subordinated debt is not allowed to be transferred. The BoG has full discretion to decide which other assets and liabilities are eligible to transfer.

The transfer price is set by the BoG, following an evaluation by one or two auditors (*sic*). Law 4021 fails to provide any guidance as regards methods of evaluation and the professional standards of the auditors and gives the widest possible discretion to the BoG to set the final transfer price, which may be null. If the BoG considers that the offers of participants to the tender are not acceptable, it may decide to either set up a bridge bank to acquire such assets (presumably at the transfer price that the BoG will have set following the experts' evaluation) or to put the bank under special liquidation.

The transfer is, by operation of Law 4021, not subject to claw-back in case of subsequent special liquidation of the transferring bank. The law also introduces a number of provisions regulating the transfer of the assets and liabilities and counterparties' rights.

If the value of the transferred liabilities is higher than that of the transferred assets, the HDISGF will make up the difference.

It is unclear how this tool will help address the systemic risk, as the respective provisions limit the protection of depositors to what they already had before the introduction of Law 4021 (the €100,000 and €20,000 thresholds are guaranteed by the HDISGF); in addition Law 4021 foresees that all other deposits (including interbank) may remain (at the discretion of the BoG) with the transferring bank, which, due to such mandatory transfer and the adverse effects thereof (both reputational and business), could be reasonably expected to have reduced prospects of –even partial– recovery.

Transfer of assets and liabilities to a bridge bank

The bridge bank is set up by a decision of the Greek Minister of Finance, following a recommendation by the BoG, for a maximum period of 3 years. According to Law 4021 the purpose of establishing a bridge bank is the partial or full acquisition of the assets and liabilities of an existing bank in order a. to ensure the continuance of all material banking services that such bank offers to the public; b. to protect the rights of depositors and investment services clients; c. to safeguard the value of the transferred assets; and d. to maximise the value of such assets in view of the bridge bank's prospective sale by the end of its term.

Upon establishment of the bridge bank the transferring bank's banking license is recalled and it is put under special liquidation.

The transfer of assets and liabilities is effected following the same procedure as that envisaged for the full or partial transfer of assets to third banks, with the following differences:

a. the transfer is subject to an opinion by the Hellenic Financial Stability Fund as regards the assets under transfer and the viability of the bridge bank; and

b. the Minister of Finance is entitled to increase the obligations (including deposits) undertaken by the bridge bank (in addition to those deposits that are transferred mandatorily).

The bridge bank is capitalised by the Hellenic Financial Stability Fund and it is granted a banking license by the BoG; Law 4021 has no further details as regards the bridge bank's mode of operation and management during its life span (apart from the procedure for appointment of its Board of Directors).
The realisation of the value, if any, of the bridge bank, is effected by sale of its shares at an auction, following a valuation by an independent expert appointed by the bridge bank's board of directors. If the shares are not successfully sold by the end of the bridge bank's term, the bank is automatically dissolved and put under special liquidation.

Conclusion

Law 4021 aspires to introduce novel prevention and resolution measures (most of which seem to be originating from the EU Consultation Paper), to address the adverse circumstances that Greek banks are presently undergoing. However, contrary to the EU Consultation Paper, it is too generic in most of its provisions and fails to provide clear guidance on the practical implementation of the measures, delegating this task to the BoG.

A significant fault of Law 4021 is that there is no systemic categorisation of the measures it introduces (e.g. on the basis of an escalating risk to financial stability or on the basis of level of intervention to the bank's business); it also lacks guidelines regarding valuation methodologies and provides very limited safeguards for the banks' counterparties in structured finance arrangements, security arrangements, financial collateral, set-off and netting.

Moreover, the new law seems to be targeting smaller size banks, many of which have a limited number of shareholders, are not listed and which may, due to their size, run the risk of radical deterioration of their entire operations – hence the introduction of the good bank concept. By ignoring the EU Consultation Paper's proposal for the design of a bad bank alternative, where only the "toxic" assets are removed from an -otherwise- healthy banking group, Law 4021 restricts the banking regulator's powers to effectively assist the larger Greek banks (whose operations, due to their size, complexity of businesses and geographical expansion, are difficult to transfer swiftly to a bridge bank) to continue their business during a financial crisis with the least possible adverse effect on their shareholders, clients and creditors.
Finally, the effectiveness of this new set of measures will depend heavily on the BoG –which is given very wide authorities, both as a regulator and as a legislator; moreover, under the new law, the BoG will be expected to respond swiftly and aptly to extraordinary circumstances and to undertake the additional role of the evaluator of banking businesses and of the selling agent thereof.

Given the rapid changes of global and domestic economies, Law 4021 may soon be tested in practice; in addition to the concerns raised in the previous paragraphs, challenging questions, such as whether Law 4021 is compatible with other Greek and EU legislation and whether the measures introduced can pragmatically transcend from theory to practice, will need to be addressed quickly, accurately and unambiguously – if the new law is to have any positive effect in the prevention of systemic and legal risk and the financial markets' jitters that the failure of a Greek bank may bring about.

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