Ministry of Finance of the Czech Republic

Statement to the European Commission's Staff Working Document: An EU Framework for Cross-border Crisis Management in the Banking Sector

20 January 2010

The Ministry of Finance of the Czech Republic welcomes initiatives of the European Commission to enhance crisis management and resolution or orderly winding up of failing cross-border banks. The Ministry highly appreciates the possibility to provide the Commission with the following comments on this issue.

The following comments cannot be considered at this stage as the final official policy position due to complexity of the discussed issues.

A. General comments

Firstly, we consider an effective crisis management for cross-border financial institutions to be one of the most fundamental issues in the area of financial services. The cross-border crisis management in the banking sector presents a complex issue; an establishment of the relevant framework will thus be challenging.

Therefore, we are of the view that it is essential to set up such prudential rules which aim at further limiting of the possibility that a single bank gets into the financial troubles leading into losses of confidence of the depositors. In other words, ***strong prudential rules applied by banks should be perceived as a precondition of the more resilient banking system.*** *This is why the Ministry supports the work of the Commission on the mitigation of excessive procyclicality, increase of capital buffers and quality of capital, measures supplementary to the risk-based requirements of the CRD to address leverage or liquidity risk etc. We believe that any proposals will be carefully considered and final solutions will be made after considering the impacts on the banking sector.*

We also think that the review of the guarantee schemes directive is relevant part of the whole process.

Secondly, we think that an EU regime mentioned at different forums should be clarified. Nevertheless, the Ministry supports the activities struggling for the enhanced ***coordination between relevant authorities and harmonization of the legal framework*** *regarding the crisis management. The potential introduction of a new pan – EU regime would require special arrangements at the EU level subject to political agreements. We agree that the current regime is ripe for change. However, we believe that this change should be conducted in a pragmatic manner not overstretching the level of ambition. The concept of the cross-border crisis management should thus in our view lie in the close and effective coordination of the measures taken by the authorities of the affected Member States.*

We are of view that the EU legislation should be amended in such a way that the national legal frameworks would be harmonized. Within the work on enhanced coordination between relevant authorities and harmonization of the legal framework we support the identification of

the obstacles which obstruct a successful prevention and management of the crisis. The more harmonized EU framework for the cross-border crisis management should:

- *enable to fail any bank regardless its size, importance etc,*
- *remove the obstacles to crisis resolution at the national level,*
- *adjust the Company Law and Insolvency Directives in order to simplify the procedures for the crisis resolution,*
- *provide with competent authorities a wider range of tools harmonized across the EU including the measures applied with respect to shareholders etc.,*
- *clearly define the powers of supervisors in order to prevent the adopted measures from being subsequently challenged,*
- *clarify the principles for the burden sharing.*

For the decision-making processes by national supervisors in respect of which tools/measures are appropriate it is crucial to have the right and up-to-date information about the financial soundness of an institution. Therefore, we consider the introduction of the effective system of information sharing to be very desirable in order to enable all stakeholders (ailing bank, group members, authorities etc.) to be promptly provided with the relevant information. We believe that the established colleges of supervisors will play a fundamental role in this respect.

Because of the complexity of the issues priorities as regards the defined tasks should be stipulated at the beginning of the whole process.

Finally, as a next step if necessary ***the possible approaches to an EU regime of the cross-border crisis resolution could be elaborated*** *explaining how the individual aspects of the framework would function as a whole if this approach were perceived. A detailed cost benefit analysis would have to be carried out for each of the considered approaches.*

Not only the experience of the last two years could be reflected but the lessons from the previous crises could also be taken into account.

It would also be useful to set up a general schedule of the whole process including specification of Directives which would require the potential amendments.

Only after that should the most appropriate approach be selected and any drafting could take place based on political agreements. The prospective legislative proposals should e.g.:

- *contain balanced solutions. If at all the changes in powers of any national authorities were made they would have to be accompanied by changes in the authorities´ responsibilities;*
- *respective safeguards not only for creditors would have to be introduced as the issues are related to e.g. the Member States fiscal responsibility. The current exclusive responsibility of Member States regarding the financial stability and stability of national financial markets do not allow to subordinate Member States interests to e.g. the "group interests";*
- *clearly define bindingness of relations and procedures as well as the tasks carried out the relevant authorities;*
- *stipulate whether an EU regime would be obligatory or voluntary, e.g. whether the most important EU cross-border groups might only be subject to the regime,*
- *clearly define the role of the relevant authorities in the processes.*

Having in mind the complexity of the issues being discussed in connection with an EU resolution framework for cross-border banks we would like to express our strong believe that any potential intentions representing any change in the responsibilities of any national authority will be thoroughly discussed at the highest EU level so that a clear and strong political mandate would be provided in this respect.

B. Answers to the questions

Question 1
Should an EU regime focus exclusively on deposit-taking banks (as opposed to any other regulated financial institution)?

We agree with the opinion that deposit-taking banks play a vital economic role since they are providing financial services which are necessary for the functioning of the economy. On the other hand also financial institutions which perform only some of these functions may threaten the stability of the financial system as well as deposit-taking banks due to the mutual inter-connectedness of financial sectors. Having said that, in principle, we would agree an EU regime for Cross-border Crisis Management would focus on all financial institutions. Nevertheless, we would recommend that in the first phase the deposit-taking banks could be primarily brought into the focus because of difficulty to solve all financial institutions en bloc as well as because of the divergence of appropriate solutions for different kinds of financial institutions. Only after that it could be analyzed and defined which of the other financial institutions the EU regime should apply to and to what extend. However, it is desirable that an EU regime would be available to the respective regulated entities (i.e. banks together with other financial institutions) at the same point of time.

Question 2
Should an EU regime apply exclusively to cross-border banking groups, or should it also encompass single entities which only operate cross-border (if at all) through branches?

We consider a uniform approach as the most desirable one. We would therefore prefer the EU regime to apply to all cross-border financial institutions as well as to the entities which only operate cross border through branches. We believe that in this context all financial institutions should be treated in the same manner and an EU regime should be applied to these institutions without any exceptions, otherwise there is possibility for some entities to evade rules and to avoid the application of an EU regime. With regard to the integrated markets and activities it is increasingly difficult to resolve deposit-takers in isolation which represents another supporting reason for this opinion. However, we believe that there is no reason for the EU regime to apply also to the institutions of only national character, i.e. not operating cross border.

Question 3

Should an EU regime apply exclusive to „systemically important" institutions ? If so, how should this concept be defined and how should the relevant institutions be identified?

In our view determination of clear and exact characteristics of the „systemically important" institution and the identification of institutions that fall into this category constitutes a huge problem to which there is no satisfactory solution. We are not persuaded that the identification of several characteristics of systemically important institutions like size, inter-connectedness or complexity would bring the intended outcome. The determination of factors by a simple definition would not cover all necessary cases and a more complex definition which would offer a more comprehensive coverage of risk would be connected with difficulties in the implementation process. Moreover, we are convinced that such determination of the characteristics of systemically important institutions would be counterproductive. Potentially systemically important institutions would probably make all the efforts not to reach the critical values of the defined indicators.

Therefore, we would prefer the EU regime to apply to certain financial institutions and their groups defined in the legislation and under the conditions stipulated there. Other financial institutions could accede to the regime on a voluntary basis provided that relevant requirements, e.g. an approval by the competent authorities, were met.

Question 4

Do supervisors need additional tools and powers for early intervention, and if so, which?

The CEBS Survey[1] has shown a huge disproportion in powers and tools available to supervisory authorities. This is not an ideal situation. We consider the early intervention to be the most important phase of the discussed crises management. Because of this importance and of the differences identified by CEBS we believe that a minimal harmonization should take place in this area. We appreciate the suggested division of tools/powers concerning corrective measures, early intervention, crisis management and sanctioning powers made by CEBS into the following categories[2]:

- *Measures aimed at restoring compliance and soundness,*
- *Sanctioning powers that operate through public notices,*
- *Measures directed at the management body of the institution,*
- *Measures directed at the shareholder,*
- *Capital-related measures,*
- *Measures related to pre-insolvency situations and insolvency proceedings,*
- *Other administrative measure.*

We propose using this segmentation (or a similar one) and define a minimum set of measures/tools in every „basket" which would be available to every national supervisor. A choice of other additional measures/tools should be left to the discretion of national supervisors.

[1] CEBS, Mapping of supervisory objectives and powers, including early intervention measures and sanctioning powers, March 2009 (http://www.c-ebs.org).

[2] ibid.

We consider it useful for all supervisors to have these minimal common measures/tools, e.g. we believe these measures/tools should be harmonized at the EU level (i. e. covering not only early intervention but also resolution and insolvency stage):

- *Measures aimed at restoring compliance and soundness (e.g. the power to limit or impose conditions on the business of an institution, to require an institution to cease certain practices, to impose stricter prudential requirements or require an adjustment in the risk profile, temporarily suspend the exercise of all or part of an institution's activities, to limit intra-group transfers and transactions as well as transfers or transactions outside the group and of course a general power to impose - or require an institution to take – any measure that is deemed appropriate to restore compliance with legal requirements, including the power to require an institution to enhance its governance, internal controls and risk management systems),*
- *Measures directed at the management body of the institution (e.g. the power to oppose the nomination of the persons who effectively direct the business, to suspend or replace directors and managers and to appoint a person/body with general or specific powers in times of difficulties, e.g. an administrator),*
- *Measures related to pre-insolvency situations and insolvency proceedings (e.g. the power to suspend the exercise of all or part of an institution's activities or prohibit such activities altogether, to withdraw a licence,),*
- *Other administrative measure (e.g. power to trigger the deposit guarantee scheme).*

Moreover, there should be some clear-cut definition of intervention measures/tools available in all EU Member States to ensure that an individual measure/tool in every Member State has the same content and meaning.

In our opinion it might be also considered whether supervisors should not have at their disposal the power to require a change in the group structure if they consider it necessary, e. g. for being non-transparent.

Question 5

Should the application of early intervention measures only be the result of supervisory (joint) assessment of emergency situations, or would there be any advantage in structured or automatic triggers for early intervention?

Generally speaking we would prefer a mix of automatic triggers and discretion since both of these approaches have advantages and of course disadvantages. Structured and automatic triggers eliminate an individual discretion. On the other hand, the supervisory assessment of emergency situations can reveal some situations (incl. frauds) which cannot be caught by automatic triggers. Nevertheless, according to the CEBS Survey there are only a few automatic triggers used by supervisory authorities. In addition, automatic triggers represent outer limits and the aim is to recognize a financial difficulty at as early stage as possible, i.e. to set these triggers stricter. Moreover, national supervisors should have a possibility to review the financial situation and consider whether there is or not a threat to stability/ a beginning of instability of the banking or financial system as such.

We are of the opinion that the automatic triggers used in the Czech Republic might be considered in this respect. According to the Act on banks if the supervisor (the Czech National Bank) becomes aware that a bank's capital on a solo basis is lower than two thirds

of the sum of the individual capital requirements, it shall in administrative proceedings impose the given remedial measures on the bank.[3]

Moreover, the Czech National Bank shall revoke the licence if it becomes aware that the bank's capital on a solo basis is lower than one third of the sum of its individual capital requirements.

To sum it up, we support an EU regime combining the structured (or automatic) triggers with the supervisory assessment of emergency situations.

Question 6
Is any modification of the current framework for the supervision of branches necessary or desirable?

We are aware of the fact that formal framework for the cooperation of supervisors has already been enhanced (e.g. supervisory colleges, cross-border stability groups), now it is necessary to implement it in practice. We consider necessary to substantially improve and reinforce the cooperation of national supervisors in order to ensure that relevant information is available as soon as possible to all respective authorities. Of course agreed terminology and common indicators are connected with this requirement.

We agree with the present status according to which the supervision of the liquidity of the cross-border branches of a credit institution is the responsibility of the supervisor of the host Member State where the branch is established.

[3] Act on Banks, section 26a, subsection 1: If the Czech National Bank becomes aware that a bank's capital on a solo basis is lower than two thirds of the sum of the individual capital requirements within the meaning of Section 12a(1), it shall in administrative proceedings impose one or more of the following remedial measures on the bank:
a) to increase its capital such that the capital of the bank on a solo basis is at least equal to the sum of the individual capital requirements within the meaning of Section 12a(1),
b) to acquire assets which, according to the decree issued under Section 12a(8), have a risk weighting of less than 100% only,
c) not to acquire any share of the capital and voting rights of any legal entity, except for agreements concluded before the imposition of this measure, and not to establish or acquire any other legal entity or organizational unit thereof,
d) not to provide any loan to a person having a special relation to the bank,
e) not to offer interest rates on deposits exceeding the usual current interest rates on deposits of like amounts and with like maturity as ascertained by the Czech National Bank.
Act on Banks, section 34, subsection 3: The Czech National Bank shall revoke the licence if it becomes aware that the bank's capital on a solo basis is lower than one third of the sum of its individual capital requirements. The Czech National Bank shall not be obliged to revoke the licence in this case if the bank is a bank under conservatorship or a special-purpose bank.

Question 7

The Commission Services invite views on a requirement for „wind down“ plans. In particular:

a.) Would „wind down” plans provide useful information to managers and supervisory authorities?

In our point of view these plans can be useful in general. However, the effectiveness will very much depend on the content of the plans. The rightly selected criteria can provide both managers and supervisors with useful information, especially indication of weaknesses or threats for the business of financial institutions. These „wind down“ plans could help managers and owners to identify problematic aspects of activities of their company and could be a prerequisite for remedy actions at an early stage. We are aware that „wind down“ plans are primarily considered as a means of facilitating a more rapid resolution or winding down of the financial institution, but this document may be usable for planning how to avoid instability and financial stress. That is why also supervisory authorities would profit from “wind down” plans.

b.) What kinds of institution should be required to prepare them?

*We are of the opinion that an obligation to prepare wind down plans could be established with respect to all financial institutions. Of course there would have to be differences in the content and detail for cross-border financial institutions and small banks resulting from the size of institution and other agreed relevant factors (e.g. market share, substitutability, interconnectedness and cross-boarder activities, complexity, portfolio of provided services)**,** but on principle these plans should have the same form.*

c.) What should be the content of wind down plans?

The content of wind down plans represents another key aspect of this idea. Some of issues are already mentioned in the working paper (e.g. lists of counterparties, location of inventory assets, details of client assets etc.). Resolution plans could include both plans, to be prepared in first instance by each firm, to reduce its risk-exposures and make its structure more effective in a “going concern” scenario, and wind-down plans, to be prepared by the authorities, in a “gone concern” scenario. However, the content of wind down plans should be carefully analyzed and a cost benefit analysis should be carried out before any decision is taken.

Moreover another aspect has to be mentioned in this context – the determination of the frequency of wind down plans update. It is necessary to set a reasonable period for the plans update to avoid an excessive administrative overloading of financial institutions on one hand and on the other hand to ensure that the data contained therein are actual.

d.) Should the development of wind down plans be closely linked to the design of a cross-border resolution framework?

If there is devised an EU cross-border resolution framework, such a framework could include wind down plans too. These measures are connected and should be in an absolute compliance. Nevertheless, the aspect of costs on the preparation such plans has to be taken into account.

Question 8

The Commission Services invite views on the advantages, if any, of designing a framework for asset transfers along the lines outlined above.

Asset transfers in the Czech Republic banking sector constitute a very sensitive issue due to the historical experience in 1990's. Generally speaking the Czech company law contains a set of provisions which enable asset transfers under certain circumstances (e.g. under the domination agreement[4]). These provisions have validity for all kinds of business entities, nevertheless, banks are regulated by the special act which poses on banks stricter requirements, limits common provisions from the Commercial Code and has a priority in use (Act on Banks[5]). According to the Act on Banks all banks are prohibited to conclude contracts under noticeably disadvantageous conditions, especially for unfair considerations.

We are aware that „transfer of assets within a cross-border banking group (i.e. across different legal entities located in different Member States) is a common and everyday transaction in the normal course of business"[6]. Nevertheless in case of a developing crisis there is a growing discredit of the affected institution and the new „suspect" situation changes the position of the afflicted institution. There is a conflict of interests in this situation. On one hand the problem bank could be saved by asset transfer, but on the other hand this operation could be realized under nonstandard (preferential) conditions which are disadvantageous for the transferring bank. Moreover, this asset transfer may support crisis contagion to another Member State.

We fully agree with the opinion that most barriers to asset transfers represent legitimate protections for stakeholders and national financial stability. However, we do not object

[4] Commercial Code, section 190b, subsection 1: „Under a domination agreement, one contracting party („the managed person") agrees to be subject to common management by another person („the managing person")".
Commercial Code, section 190b, subsection 2: „The managing person's statutory organ is entitled to give instructions to the controlled person's statutory organ, including some which might be disadvantageous to the managed person, if such instructions are in the interest of the managing person or another person within a holding-type group."

[5] Act on Banks, section 12, subsection 1: „A bank or a foreign bank branch shall carry on its activities with prudence and, in particular, pursue its business in a manner which is not detrimental to the interests of its depositors in respect of the recoverability of their deposits and which does not endanger the bank's safety and soundness.
Act on Banks, section 18, subsection 1: „A bank may not enter into transactions with persons having a special relation thereto (Article 19) which would otherwise, owing to their nature, purpose or risk, not be entered into with other clients."

[6] Commission services feasibility report on „asset transferability" within cross border banking groups, November 2008, p. 4.

exploring the EU framework permitting or facilitating the transfer of assets between affiliated entities. Therefore, we would welcome a thorough analysis of possibilities of an EU framework for asset transfers with the aim to establish a framework comprised of adequate rules and safeguards which would ensure that interests of Member States are not jeopardized.

We believe that the following rules should govern the asset transfers:

1. *Rules for asset transfers should be embedded in the binding legislation;*
2. *The notion of asset transfer should be clearly defined;*
3. *It should be clearly stipulated which assets may be subject to transfer;*
4. *There should be a notification duty for cross-border banking groups and every entity concerned should agree with the transfer; also the relevant national supervisor should have a competence to prohibit the intended transfer on the ground of financial stability of the national banking/financial system;*
5. *The consequences of the asset transfer for the transferring as well as accepting entity should be clearly defined;*
6. *The rights of creditors should not be hampered; the rights of shareholders should be clearly defined.*

Question 9
What are the appropriate safeguards for creditors?

Having in mind asset transfers, we are of the view that the crucial issue is how a new EU regime will be devised, how ambitious a future proposal will be.

Taking into account the responsibility of Member State for the financial stability, we are of the view that the appropriate safeguards would be commitments provided by parent undertakings with respect to their foreign subsidiaries. These should be a precondition for the introduction of asset transfers within cross-border groups.

Question 10
Is the concept of „banking group“ worth exploring further?

In our point of view the concept of banking group (or group interest) cannot prevail over the interests of creditors, investors and the responsibilities of Member States pursuant to the current EU legal framework. The exclusive responsibility of Member States regarding the stability of national financial markets would not allow to subordinate MS interests to groups interests.

We would tend to support further exploration of this concept which might be under certain circumstances helpful in managing of the cross-border crisis in banking sector in the future when adequate safeguards are introduced. The Rozenblum judgment may serve as a starting point for discussions concerning asset transfers. We consider the principles enumerated by the court in this case to be reasonable. However, it is necessary to take into account the fact that the intention is to consider asset transfers within cross-border banking groups, i.e. across Member States, which is a completely new aspect of the issue requiring extraordinary caution.

Question 11
Which objectives should bank resolution tools seek to pursue? Which objectives should be prioritized?

From our point of view a vital objective of bank resolution tools should be a preservation of financial stability and depositors confidence in this stability, because bad news (even if fictitious) concerning financial soundness of financial institution may cause run on banks, liquidity problems and subsequent collapse. Second goal represents effective protection of the interests of creditors and business counterparties. And finally in case of bank default the resolution tools should ensure an ability to resolve a liquidation of a failing bank in order to minimize impacts on the state budget. Last but not least, all steps have to be taken as soon as possible, because only prompt intervention brings desirable results.

Question 12
What resolution measures are necessary? In particular, would the resolution tools outlined in paragraph 93 be appropriate and sufficient for an EU regime?

We prefer an EU agreement on the minimum package of resolution measures which should be available to all European supervisors. The threat of bank instability needs quick and decisive steps in order to minimize the possible costs to depositors, creditors and taxpayers. The resolution process has to be as prompt as possible, because the administration has no positive effects on the bank's goodwill and may lead to efflux of capital and render this process unsuccessful.

We agree that the resolution tools mentioned in paragraph 93 represent a convenient base for an EU cross-border bank resolution framework which might be implemented within an EU regime.

In the Czech Republic a new regulation introducing similar measures has been adopted recently. The Czech law enables to transfer bank's business to a „bridge bank"[7] owned by the Czech Republic. Another resolution tool which is designated to separate toxic assets from the good ones – a concept of good/bad bank has also been adopted in the Czech Republic[8].

[7] Act on Banks, section 16, subsection 5: A bank may also transfer its business to a joint-stock company whose sole shareholder is the Czech Republic, provided that the joint-stock company complies with the minimum capital requirement laid down in Section 4(1) (hereinafter referred to as a "special-purpose bank"). A special-purpose bank fulfils the conditions for granting a licence pursuant to Section 4(5) if the Czech National Bank grants its prior consent to the conclusion of an agreement to transfer the business to the special-purpose bank; in that case, the Czech National Bank shall grant it a licence covering the activities given in the licence of the bank transferring the business. A special-purpose bank shall not carry on the activities given in the licence before the day on which the agreement on the transfer of the business takes effect, which may be no sooner than on the day on which the licence is granted to the special-purpose bank.

[8] Act on Banks, section 29a: In order to conclude an agreement on the takeover of the debts of a bank under conservatorship by another bank or foreign bank branch:
a) the consent of creditors shall not be required,
b) the prior consent of the Czech National Bank shall be required; the Czech National Bank shall grant its consent only if the entity taking over the debts ensures proper and smooth continuation of client relationships connected with the debts being taken over.

Moreover, the national supervisor in the Czech Republic is also entitled to impose a conservatorship if the bank's activities threaten the stability of the financial system[9]*. The conservator (administrator) is an employee of the Czech National Bank and is entitled to act in the capacity of the statutory body. Furthermore the General Meeting of the bank does not take place and the conservator is entitled to decide on matters falling within the powers of the General Meeting. Last but not least, the Czech supervisor has the power to suspend the exercise of all or part of the institution's activities or prohibit such activities altogether.*

Question 13
Would administrative reorganization (as described) be a viable option for financial institutions – or might there be a risk that the appointment of an administrator could exacerbate liquidity problems due to loss of confidence?

Of course the appointment of an administrator always contributes to a loss of confidence therefore speedy procedures are more than desirable. This might pose a challenge even for competent authorities as relevant procedures have to be activated.

In our opinion administrative reorganization might be an option. However, it might be useful to consider more deeply the advantages and disadvantages of the reorganization, i.e. clarify why the procedure of administrative reorganization would be more suitable with respect to regulated entities in comparison with common judicial proceedings.
We would also propose considering similar measures mentioned in previous answer (bridge bank, good/bad bank, conservatorship).

Question 14
What threshold conditions would be appropriate for the use of resolution tools?

We understand the threshold conditions for the use of resolution tools as the conditions for intervention taking place before the bank is technically insolvent, which represents an important stage in the crisis management framework. In our point of view to ensure the continuity of banking services and to protect and enhance the financial stability in Member States it is desirable to set the threshold conditions in such a way that they are able to detect problems in a bank at an early stage. We are convinced that application of exclusively pure „hard solvency triggers" is not suitable for the resolution phase. Although "hard triggers" can provide the supervisor with the information indicating that a potential threat to the bank soundness is arising they do not enable an individual assessment. Therefore – for the resolution phase – we would prefer a combination of the „hard solvency triggers" with the „soft regulatory thresholds" which encompass discretion of the relevant supervisor and enable an individual approach to each institution and fair assessment of the financial situation of the entity concerned. It should be fully left to discretion of the national supervisor which resolution tool will be applied (administration, bridge bank, good/bad bank). The national supervisor may exercise the resolution power only if the exercise of the power is necessary having regard to certain public interest (stability of the financial system, the maintenance of public confidence in the stability).

[9] Act on Banks, section 30, subsection 1: The Czech National Bank may impose conservatorship in the situation where shortcomings in a bank's activities endanger the stability of the banking or financial system.

Question 15
Should different conditions be defined for the use of different tools, and in particular in the case of a graduated approach to resolution?

In our point of view an initialization of a debate on different conditions for the use of different tools would be very useful. Moreover, a common set of measures/tools which would offer various approaches to the resolution should be agreed on. The application of the relevant measure/tool would respond to the seriousness of the financial situation in the affected institution. The prior application of the „non-graduated measure/tool" should not be a precondition for the use of the „graduated one". The choice of the relevant measure/tool depending on the situation of the bank and the financial market should be left to the discretion of the national supervisor.

Question 16
What kind of specific protection and support measures are needed in the context of partial transfers or the splitting of a group, including measures for the protection of creditors.

Because a pre-insolvency partial transfer could disadvantage the creditors whose claims are not transferred, we are convinced that all creditor's claims should be transferred to the „new entity". Otherwise the creditors remaining in the residual bank may be worse off without any reasonable justification. Such an unequal treatment (leaving certain creditors in the residual entity) at this stage would require a detailed legal exploration; nevertheless this approach is regulated by the insolvency law. We recommend separating these measures into measures for resolution and insolvency proceedings.

The process of transfer of bank's business has similar character as an expropriation and therefore this interference with the constitutional principle „expropriation for compensation" has its response in the legal regulation in the Czech Republic. The Act on Banks presumes a valuation of the business and related rights and obligations[10]. In case that the result of the valuation is not a positive figure a purchase price of CZK 1 shall be paid to the seller.

Question 17
What changes to insolvency law would be necessary to support bank resolution measures (e.g. moratorium, post commencement financing etc.)?

First of all we should clearly distinguish between pre-insolvency and insolvency proceedings, because these two phases have different conditions, subjects and goals. We would recommend concentrating all efforts on the administration phase, because the aim of this stage is to sanitize an ailing bank. The insolvency proceedings should represent the final solution for the failing bank – i.e. winding up. Therefore this answer deals only with the pre-insolvency proceedings; the insolvency proceedings are subject of the answers to questions 23-25.

[10] Act on Banks, section 29b, subsection 1: If a bank under conservatorship sells the bank's business, the purchase price shall be determined as a result of a valuation of the business and related rights and obligations as of the day on which the agreement on the sale of the business takes effect (hereinafter referred to as the "valuation").

Therefore the resolution process could encompass measures taken by the national supervisor as follows (in case of administration, i.e. without judicial participation):

- *a decision whether to impose an administration,*
- *an appointment of an administrator,*
- *a duty of the bank officers to give assistance to the administrator at his request, otherwise the national supervisor/administrator is entitled to impose a fine on such a person if this duty is breached,*
- *a suspension of the duties of all bodies of the bank at the moment the decision to impose administration is delivered (administrator shall act in the capacity of the statutory body),*
- *an empowerment of an administrator to decide on matters falling within the powers of the General Meeting,*
- *a possibility of a bank under administration (with the prior consent of the supervisor) to suspend partially or fully the depositor's rights of disposal of their deposits,*
- *a possibility of a bank under administration to suspend partially or fully payments to persons with a special relation to the bank resulting from legal titles arising before the imposition of administration,*
- *a possibility of the national supervisor to render during an administration a financial assistance to the bank to overcome any temporary shortage of liquidity, the claims for repayment of this financial assistance shall have priority over all other liabilities of the bank,*
- *a possibility of the national supervisor to restrict the rights of the counterparties to terminate contracts,*
- *an administration should be time limited.*

In case of failure of the above-mentioned resolution measures the insolvency proceedings should follow.

Question 18
What safeguards are needed for financial contracts and commercial arrangements that may be affected by partial property transfers?

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Question 19[11]
Is it necessary to derogate from certain of the requirements imposed by the EU Company Law Directives and, if so, what conditions should apply to any such derogation? If the scope of an EU special resolution framework extended beyond deposit-taking banks to cover other financial institutions (see Chapter 1), should such derogations from the EU Company law rules apply to all financial institutions covered?

We would like to mention that any potential changes to the EU Company Law Directives and more generally, to any other relevant legislation, if deemed necessary, should be based on proper analysis of the goal, i. e. the desired features of the resolution framework. It means that we should firstly define what we want to reach (our common goal) and consequently agree on necessary changes to the current legislation. In any case the detailed exploration of

[11] The following answers were prepared in cooperation with the Ministry of Justice of the Czech Republic.

the affected provisions and cost/benefit analysis should be carried out before any drafting takes place.

Nevertheless, from our point of view, it might be desirable to suspend at least the following requirements imposed by the EU legislation in order to facilitate the resolution process:

a.) The Article 25 of the Second Company law Directive (77/91/EEC) that provides that any increase in capital must be decided upon the General Meeting. Under specific conditions and with regards to flexibility of a forced bank administration an administrator should have an option of capital increase without the consent of a General Meeting. The specific conditions of mentioned option should include an adequate guarantee of shareholders rights protection, especially maintenance of their pre emption right to subscribe pro rata for any newly issued shares except in case when a bank doesn't implement a corrective measure of capital increase in due time, as imposed by the supervisory authority.

b.)) The Article 30 of the Second Company law Directive (77/91/EEC) that provides that any reduction in the subscribe capital, except under a court order, must be subject at least to a decision of the General Meeting. Again, an administrator should have the option of capital reduction without the consent of General Meeting as in the case of increase in capital.

c.) The Article 5 of the Directive on Takeover bids (2004/25/EC) that imposes the obligation to make a bid for other shareholders' shares on each person who has acquired control of a listed company. The acquisition of control of the company can be advantageous for shareholders when it serves to prevent a bankruptcy and the acquirer should not be required to make a bid in such situations. Supervision Authority may be authorised to verify whether such exemption is justified in specific cases.

The legal provisions imposing formal obstacles such as a duty to convene a General Meeting or to gain an approval of the General Meeting in certain cases might be capable to obstruct successful resolution of an ailing bank. In case of the crisis development of the financial soundness, the shareholders should not retain their rights to approve bank restructuring measures which could affect their ownership rights, but only if this interference is justified in the public interest. Any interference with the shareholders' rights should thus represent the outer measure. Of course the provisions containing interferences with the possession have to be embedded in the legislation. We are convinced that resolution measures taken by the authorities should be subject to a judicial review; however, this review should not reverse the adopted resolution measures but only affect the amount of the compensation.

As we mentioned in our answer to Question 1, we prefer a uniform approach and therefore any derogations from the company law should be applicable to all financial institutions.

Question 20

The Fortis case has shown that requirements imposed only at the level of the national law, or allowed by it, can also impair effective measures to save an ailing bank. Is it therefore necessary to regulate at EU level to ensure that such national rules do not apply in where measures are taken under a bank resolution framework? If so, what conditions should apply to any such derogation from national rules?

In accordance with our previous answer we are of the opinion that a harmonization of legislation adjustments facilitating the resolution process and containing the appropriate safeguards could be adopted at the EU level. It might be useful to introduce into national legal orders the same (or similar) measures/tools which enable the resolution process without any delays or obstacles.

In order to better understand the Fortis case and to fully draw on lessons learned it might be useful to base further discussion on a detailed analysis.

Question 21

What kind of triggers or conditions are likely to best deliver the objectives set out in paragraphs 132-133, and to ensure that intervention in the field of shareholder rights is proportionate and justified? In particular, should these triggers or conditions be the same as those discussed in Chapter 5, or should the conditions for interference be stricter where shareholders' rights are at stake.

From our point of view the national supervisors should takeover the main responsibility in case of intervention and it should be fully left to their discretion. The barriers for the discretion which measure(s) to use have to be clearly embedded in the binding legislation. Moreover, we appreciate the need to limit shareholder's rights only in exceptional circumstances. Czech laws consider imposition of the forced administration as a threshold in some similar cases (e.g. forced administration as a condition for a bad/good bank), in others it could be a serious risk of bankruptcy (bankruptcy or a danger of bankruptcy as a condition for insolvency). An independent authority (banking supervisor or takeovers supervisor, when not integrated) could be responsible for declaring or assessing whether the threshold was reached in particular cases, subject to review by courts.

We are of the opinion that shareholders and the bank management appointed by the shareholders are in general primarily responsible for the bank instability and difficulties and this should be reflected in the approach by the authorities, i.e. relevant shareholders rights might be suspended and the powers of the board of directors or/and the supervisory board might be delegated. We would like to point out that shareholders rights should be subordinate only and exclusively to the public interests in financial soundness of the banks and the financial stability of the national markets. The interference with the shareholder rights would therefore present the outer measure.

Question 22
Should mechanisms for compensation be set out at EU level, and if so how should this be done?

We do not see the need for additional rules regarding compensation, when the measures are used in exceptional and justified cases, fully in accordance with the basic principles laid down by the European Convention of Human Rights (ECHR). In the end, the shareholders are responsible for the good governance of the company and should also bear the consequences when the company fails.

In addition we consider useful to introduce EU rules for compensation in case of asset transfer (mainly sale of business) during forced administration to a bridge bank or another financial institution. This rules should cover how the price is set (for example based on an expert opinion), how the relevant expert is chosen to ensure his/her independence (for example by the supervisory authority), and that the price may be set ex post to allow a smooth sale of business as soon as the need arises.

Question 23
Are mechanisms for cooperation and communication between authorities and administrators responsible for the resolution and insolvency of a cross border banking group desirable? The Commission services would also welcome views on the form that such mechanisms might take.

We consider the effective and prompt mechanisms for cooperation and communication between relevant authorities responsible for insolvency proceedings as well as for resolution stage to be most desirable. We are of the opinion that all relevant information has to be available to the respective authorities of the affected Member States as soon as possible. The rest of the Member States should be provided with the general information concerning the crisis development in the financial sector.

Question 24
Is a more integrated resolution and insolvency framework for banking groups feasible and desirable?
– In particular, should the Commission explore mechanisms at EU level for the extension of liability, contribution orders and pooling or substantive consolidation in relation to cross border banking groups.

We welcome the general discussion about the possible amendments of the EU legislation concerning cross-border insolvency impacts on the consolidated companies, nevertheless not only for the banking sector. We agree with the Commissions´ intention that burdens connected with the problems solving of the banks should be carried by shareholders and creditors instead of taxpayers. We support a general discussion on this subject; nevertheless we are afraid there is no simple solution of this issue. The question of the cross-border bankruptcy has been dealt with on the international level for a long time (EU as well as UNCITRAL), however without feasible results. Nevertheless, we consider the Early Intervention phase to be the most important, because it implies no financial impacts on the state budget.

Generally speaking, we would prefer a more coordinated insolvency framework for banking groups, i.e. introducing of EU rules requiring courts, insolvency officials (national supervisors respectively) to exchange information about the entities under insolvency regime. We are not convinced that it would be feasible to introduce a more integrated approach in this area at this time. The idea of the European Resolution Authority represents a sensitive issue and we do not believe that it would be realizable.

Question 25

Would a "28th regime" be useful and feasible? If so, what would be the appropriate scope of its application, and the difficulties of applying it to existing entities?

We are of the opinion that an introduction of a new EU insolvency regime represents a very complex and demanding issue. However, we would prefer a gradual approach in the area of the insolvency proceedings. The first step could represent a more coordinated insolvency framework. In spite of the fact that this approach would mean the simplest form, there are several points which would need a detailed discussion, for example whether the transferred assets in the framework of the Early intervention should be treated (or not) in preferential manner in the insolvency proceedings.

As regards 28th regime we are not convinced that it should be introduced. Instead we should focus on a more coordinated approach together with harmonisation of the insolvency laws in all Member States.