



**14 November 2008**

### **Commission services' report on 'asset transferability'**

1. The ECOFIN strategic roadmap to strengthen EU-arrangements for financial stability requests a feasibility study on asset transferability from the Commission. The attached report presents its initial findings to tackle ring fencing of assets in banking groups, which is not illegitimate per se, but could hinder an optimal resolution of a distressed group. It outlines the key barriers to asset transferability and possible ways forward.
2. This survey received strong support in the European Banking Committee. Members of the EBC welcomed the fact that the report appeared to strike the right balance between the legitimate protection of stakeholders' rights, financial stability concerns in both host and home MS, and the group interest. EBC members considered the report as an appropriate basis for further work to enhance the stability of the banking system and to progress on the efficiency of group supervision.
3. Ring-fencing of assets is rooted in national company and insolvency law protecting legitimate interests (creditors, shareholders). The financial crisis clearly demonstrated that cross-border financial groups in fact constitute different legal entities in stressed situations. Ring fencing is not necessarily sub-optimal (contagion effects are limited), but in stressed situations, the EU legal framework does not provide for other alternatives than ring fencing assets or bailing out banks. In a global environment, the Commission services are of the view that those issues should not be only addressed in an EU context.
4. While the discussion on "supervisory architecture" centres on 'who does what', this survey provides further insight into 'what should be done' to fully underpin group supervision while ensuring appropriate safeguards in terms of stakeholders' protection and financial stability:
  - coupled with harmonisation of liquidity supervision, intra-group transactions could be subject to clear and operational rules;
  - to allow financial support from one entity to another, significant headway in terms of company and insolvency law is needed.
5. Those issues will be further addressed as part of Commission services' White Paper on 'early intervention' (mid-2009). As requested by ECOFIN, asset transferability needs to be considered alongside the review of the Winding-Up and Reorganisation Directive. Importantly, the financial crisis has highlighted the blurred distinction between crisis management and crisis resolution when crises materialise in a matter of days as opposed to weeks or months.
6. The Commission services would welcome comments from the EFC on this report, and in particular on the possible ways forward.



**EUROPEAN COMMISSION**  
Internal Market and Services DG  
**FINANCIAL INSTITUTIONS**  
**Banking and financial conglomerates**

**14 November 2008**

**Commission services' feasibility report on "asset transferability" within cross border banking groups**

## 1. INTRODUCTION

*To avoid counter-productive ring fencing of assets, ECOFIN requested adequate legal safeguards for any transfer of assets within banking groups*

1.1 Drawing on the report of the EFC ad hoc Working Group on EU financial stability arrangements, the 9<sup>th</sup> October 2007 ECOFIN Council requested the Commission "to perform a feasibility study on reducing barriers for cross-border asset transferability while introducing appropriate safeguards within banking, insolvency and company law, taking into account that the reallocation of assets in a crisis affects the ability of stakeholders in different legal entities to pursue claims<sup>1</sup>. The overall objective is to reinforce the primacy of private solutions, avoid counter-productive ring-fencing of assets, and facilitate a smooth management of a crisis." This draft paper/feasibility study sets out the Commission's initial findings.

The EFC ad hoc working group report made it clear that asset transferability in the context of the prevention and management of a crisis "could only be realised if critical safeguards are in place in order to preserve the legitimate interests of the entities from which the assets would be transferred". Further work was considered necessary to assess the desirability and feasibility of improving cross-border asset transferability. In particular, the EFC ad hoc working group suggested defining a set of minimum conditions to create sufficient and appropriate safeguards.

*The recent financial crisis has accentuated the need for an adequate EU crisis prevention, management and resolution framework*

1.2 Over the last months, those policy objectives have been substantiated by hard facts. In some instances, cross-border groups were placed into administration, which in turn gave rise to ring-fencing of the assets of a bankrupt group (Lehman Brothers<sup>2</sup>, Kaupthing bank, Landsbanki). Different trigger points for insolvency (in the UK and in the US) gave rise to legal conflicts regarding the transfer of assets. The rescue of Fortis has also provided an example where the splitting of support functions and ring fencing liquidity lines appears to have given rise to difficulties.

More importantly, in terms of asset transferability, the financial crisis has highlighted three dimensions which need to be taken into account in the EU crisis management framework:

- In the current legal framework, ring-fencing is legitimate. The EU legal framework in terms of banking, company and insolvency law is based on legal entities. Even if authorities are willing to fully cooperate, ring-fencing cannot be avoided.
- Asset transferability should not only be considered in terms of barriers (i.e. how to remove barriers and introduce appropriate safeguards), but also in terms of an adequate and clear framework providing both firms and authorities with legal certainty on which assets may be transferred - and how.
- As crises may materialise within a matter of hours, the distinction between 'crisis management' and 'crisis resolution' is somewhat flawed. Any attempt to improve crisis management by banks (private sector solutions) would need to be considered in the broader context of crisis resolution where authorities step in (segregation of assets within a banking group, bad/good company...) and may require assets to be transferred or to be kept in the respective entities.

*This note provides preliminary*

1.3 In support of this feasibility study, the Commission services have based their analysis on an extensive set of resources. In May 2007 the Commission issued a public consultation on the review of the Directive on reorganisation and winding-up of

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<sup>1</sup> The focus of this report is on cross-border groups (with subsidiaries in other Member States), and does not address branches. Nevertheless, it must be noted that host supervisors of branches are responsible for liquidity supervision. This also may create possible strains in stressed situations.

<sup>2</sup> Although strictly speaking Lehman was not an EU cross-border group because (no sub-consolidation in the EU)

views gathered as part of a consultation process and legal analysis...

credit institutions<sup>3</sup>. In July 2008, the Commission tasked an external consultant<sup>4</sup> to further underpin those conclusions, to identify obstacles and possible solutions. In spring 2008 the views of the supervisory community were sought<sup>5</sup>. The banking industry's input also fed into this review<sup>6</sup>. In general terms, findings indicate that all stakeholders fully support the need to address obstacles to asset transferability with a view to facilitating group-driven crisis management solutions, while recognising the huge challenges in terms of company and insolvency law, and more generally stakeholders' rights (creditors, shareholders) that an unfettered legal framework would entail.

...and takes place in the broader context of the Commission's further work on groups' reorganisation ...

This feasibility study takes place in the broader context of Commission services' work on supervisory arrangements and crisis resolution. The Commission services will also address asset transferability as part of the White Paper on early intervention tools for ailing banks, due by June 2009. As noted above, crisis management cannot be dealt with in isolation from other crisis resolution aspects. ECOFIN requested the Commission to look at the availability of tools as well as the possible extension of the Reorganisation and Winding Up Directive to cross-border banking groups. In support of the White Paper, further legal analysis will be needed. The Commission established a working group on early intervention. The first meeting of this working group took place on 31 October 2008.

....and supervisory arrangements

Importantly, allowing cross-border asset transferability from one entity to another within the same banking group has implications for the current scope of application of the Capital Requirements Directive (CRD). The Commission services have been requested to present a report to the EU Parliament and the Council by end 2011 on whether the waiver for the supervision of a subsidiary in Article 69 of Directive 2006/48/EC - currently limited to 'domestic' subsidiaries - could be extended (Article 156 of the same Directive). Asset transferability is a key condition for granting this waiver: "*there [shall be] no current or foreseen material practical or legal impediment to the prompt transfer of own funds or repayment of liabilities by its parent undertaking*". This feasibility study forms a mid-term report towards this final assessment.

## 2. WHAT IS ASSET TRANSFERABILITY?

Cross-border transfer of assets is a common transaction subject to certain legal requirements which are not precisely addressed in EU legislation

2.1 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. In the CRD, this is subject to principles of 'sound banking management' being respected (recital 52)<sup>7</sup>. But the CRD in itself does not provide clear guidance. In addition, it must be noted that the possibility for firms to transfer assets across different entities within a banking group is guaranteed by the free movement of capital under Article 56 of the EC Treaty. However, this is without prejudice to the right of Member States to "take all requisite measures to prevent infringements of national law and regulations, in particular in the field of taxation and the prudential supervision of financial institutions" in accordance with Article 58(1)(b) of the EC Treaty. In other words, the transfer of assets is possible as long as all institutions meet the respective prudential requirements (including

<sup>3</sup> [http://ec.europa.eu/internal\\_market/bank/windingup/index\\_en.htm](http://ec.europa.eu/internal_market/bank/windingup/index_en.htm)

<sup>4</sup> DBB law, using a network of law firms covering a large sample of MS (AT, BE, CZ, DE, DK, EE, ES, FR, HU, IT, LU, NL, PL, PT, RO, SE, UK) and third countries (US and NZ). This note is based on a preliminary interim report on asset transfers that will be completed by a report on groups' reorganisation and winding-up aspects due by March 2009

<sup>5</sup> On an informal basis within CEBS Task Force on crisis management.

<sup>6</sup> The EBF created a WG on asset transferability

<sup>7</sup> According to Recital 52 of the CRD, "When a credit institution incurs an exposure to its own parent undertaking or to other subsidiaries of its parent undertaking, particular prudence is necessary. The management of exposures incurred by credit institutions should be carried out in a fully autonomous manner, in accordance with the principles of sound banking management, without regard to any other considerations. Where the influence exercised by persons directly or indirectly holding a qualifying participation in a credit institution is likely to operate to the detriment of the sound and prudent management of that institution, the competent authorities should take appropriate measures to put an end to that situation."

undefined 'sound banking management' principles). This, however, is likely to become particularly sensitive in crisis situations.

Consideration is needed as to whether Member States' regulatory and supervisory rules should be further coordinated on the basis of Article 56 of the EC Treaty.

Banking groups may be willing to transfer asset from one entity to another. This has been identified as a bank-driven crisis management tool in the EFC ad hoc working group. Asset transfers used by banks for crisis management purposes may take different legal forms such as transfer of capital and collateral, interbank lending (possibly concluded on preferential terms), guarantees and liquidity back-up facilities<sup>8</sup>. This amounts to 'financial support' provided by one legal entity to another within a group. The crucial aspect with regard to asset transfers in banking is timing. Assets are expected to be promptly transferable (e.g. 24 hours in case of a liquidity crisis).

*In contrast, the US has a comprehensive framework in place (quality of assets, collateralisation requirement, safe ad sound banking requirement)...*

2.2 In the US, regulations on intra-group transfers are captured under Section 23A and 23B of the Federal Reserve Act. Section 23 A imposes quantitative limits on both i) collateral requirements on loans or extensions of credit by a bank to an affiliate and ii) on the amount of assets a bank can acquire from an affiliate. Section 23 B is a broader qualitative measure requiring that any kind of transaction between a bank and an affiliate, must be on terms that are not less favourable to the bank than would be entered into by the bank with an unrelated third party. A summary of those regulations is set out in Annex 1.

Sections 23A and 23B are diversification provisions. This is similar to the EU regulatory regime on large exposures in the CRD, but with a greater degree of both details and flexibility:

- Under the low quality asset restriction, banks may not purchase low quality assets (precisely described in legislation, see Annex 1)
- All loans or other extensions of credit by a depository institution to an institution must be secured by collateral of a certain market value and quality
- The arm-length principle is qualified by regulation, but at the same time the safe and sound banking requirements means that banks shall have in place effective policies and procedures to identify potential circumstances triggering the need for financial support (i.e. group interest)<sup>9</sup>
- The regulation provides for a comprehensive list of transactions which may be exempted. This includes transactions that are fully secured by federal securities or cash deposits, and importantly current crisis related transactions.

*...which allows asset transfers in crisis situations, as well as easing of the rule where needed.*

This framework allows institutions to transfer assets with much greater legal clarity than in the EU, and in particular in stressed situations. Nevertheless, this does not cover all crisis situations: institutions that are critically undercapitalised are prohibited from engaging in any restricted transactions, except with prior written authorisation of the FDIC.

Based on eligible collateral, this comprehensive framework allows for leeway in stressed situations. On September 14, 2008, the Federal Reserve adopted a regulatory exemption to the application of the limitations contained under Section 23 A, to be applied under certain conditions and in certain circumstances. The new exemption aims to facilitate financing by a member bank of its affiliates using securities or other assets without recourse to the U.S. tri-party repurchase agreement market. Strict conditions were required. They include: i) the bank must be at least as over-collateralized in these transactions as the clearing bank was in its

<sup>8</sup> Other financing (e.g. central bank funding, bail out...) are excluded from this overview.

<sup>9</sup> Section 23A only partially applies to 80% owned subsidiaries. In any case, the sound banking management requirement applies.

comparable repurchase market transactions, ii) the aggregate risk profile of the bank financings must be no greater than the aggregate risk profile of the affiliate's repurchase market transactions, and iii) the need to guarantee the obligations of the borrowing affiliate or provide additional security acceptable to the Federal Reserve. Any transaction not guaranteed or otherwise secured by the holding company would be subject to the standard Section 23A constraints. It should also be noted that the new temporary exemption does not create an exemption to Section 23 B (*qualitative requirements, arm-length principle*).

*In the EU, there is no specific regulatory framework for banks' asset transferability...*

**2.3** From a supervisory perspective, no regulation currently exists in the EU that expressly lays down a general prohibition on asset transferability between groups' entities. The only prudential restriction is the large exposures regime, limiting institutions' exposures (i.e. also intra-group transactions) to 25% of the respective institution's own funds. However, the CRD offers an option allowing Member States to partially or fully exempt intra-group exposures from the limit provided that the respective undertakings are subject to supervision on a consolidated basis<sup>10</sup>. There is no authorisation regime as such. In some Member States, authorisation by supervisory authorities is required. Examples include:

- In PT, a transfer is subject to authorisation by the supervisory authorities only in crisis situations. Where there are recovery measures to be implemented, the Bank of Portugal may determine that the transfer must be previously authorised<sup>11</sup>.
- In IT, transfers are subject to authorisation by the supervisory authorities when they reach a specific amount. Credit institutions must seek the Bank of Italy's prior approval if the transaction involves banks not belonging to the same group and its value exceeds 10% of its regulatory capital<sup>12</sup>.
- In PL, authorisation is required when the transferee's own funds constitute part of the assets being transferred<sup>13</sup>.

*... whose terms and conditions are governed either by national law or case laws...*

European legislation does not provide for a general framework regarding terms and conditions of transfers. However, in principle, all Member States require directly or indirectly a fair counterpart to asset transfers:

- Spanish banking law does not make it illegal for credit institutions to make transactions that can be considered disadvantageous for them. However there is a legal regime (and disclosure rules) intended to prevent potential abuses.
- The arms' length principle is directly required under e.g. CZ law
- The arm's length principle is indirectly required through civil responsibility (e.g. in Italy, Article 2947 of the Civil Code, "compulsory counterpart" in German law)
- In some jurisdictions, the concept of group interest may limit the arm's length principle (see section 4.2)
- In PL, Article 70 BL requires sufficient credit worthiness from borrowers

This fragmented framework does not provide for a clear and operational *modus operandi* in crisis situations. While some requirements are set out in legislation, most of them have been developed in case law.

*.... and national company law setting out different kind*

Asset transferability is mainly driven by an authorisation regime provided in Company law. In some MS, particular types of transfers are prohibited. In EE, for example, a general loan restriction is embodied in the Commercial code. A subsidiary may grant a loan to its parent undertaking or vice versa provided that this

<sup>10</sup> The Commission will be required to review and report on the application of this treatment to the Parliament and the Council together with any appropriate proposals by 1 January 2012.

<sup>11</sup> Article 141 of the Legal Framework of Credit Institutions and Financial Companies – RGICSF.

<sup>12</sup> For transfers "en masse" (art. 58 of the Italian Consolidated Banking Act),

<sup>13</sup> Art. 127.3 of the Banking Law.

of  
authorisations'  
regimes

does not harm the financial status of the private limited company or the interests of the creditors. In others, the authorisation by the General assembly of the supervisory board is required in different instances. Other examples include:

- *Authorisation required because of the importance of the transfer (AT for 'extraordinary transaction', in NL depending on the amount, notion of 'substantial portion' to be approved by the board of director in SE). In CZ, any transfer of assets between companies within a group of a value exceeding 10% of the share capital requires an expert valuation of the assets to be transferred and the approval of the General meeting in certain cases.*
- *Authorisation because of the importance of the transfer when it is not concluded in the ordinary course of business. In e.g. CZ if the value of the assets transferred within one accounting period exceeds a third of the company's net assets, such a transfer of assets is subject to approval by the Supervisory Board of the company. Those authorisations are not required when the transfer is agreed in the normal course of business.*
- *Authorisation required because of links between companies. In CZ, for personally interrelated companies at board level, the prior approval of the General meeting or compliance with arm's length principle is needed. In FR, authorisation is requested only when the transfer is not entered into under normal terms and conditions ('need for a regulated agreement'). In Spain, the authorisation of the General assembly is only required for the transfer of shares from a parent company to one of its subsidiary.*
- *Authorisation necessary because the transfer goes beyond the scope of everyday economic activities (e.g. in LU, PL, EE...)*

An authorisation framework is mainly driven by the need to ensure adequate protection to both shareholders and creditors. For example, in CZ, the strict regulation on intra-group transfers of assets was adopted as a reaction to a widespread practice of disadvantageous intra-group transfers in the 1990s.

For transfers of capital (capital reduction or capital increase), certain limitations do have a common European basis, namely the rules relating to capital protection set out in the Second Company Law Directive 77/91/EEC.

### 3. WHY IS THERE MERIT IN FURTHER CONSIDERING ASSET TRANSFERABILITY?

Asset  
transferability  
is a means to  
avoid ring-  
fencing...

3.1 Current experiences of the financial crisis shed light on the importance of asset transferability in crisis management. In the US, the Fed eased conditions for asset transferability between group members to help AIG subsidiaries in all States to transfer assets to the mother company and hence provide adequate collateral for vital financing. With the benefit of further hindsight, consideration will need to be given to the possible legal issues arising from the freezing of assets of Kaupthing bank and Landsbanki.

In general terms, the IMF argues that there are insufficient incentives to cooperate (which gives rise to ring-fencing behaviour): "The dominant strategy for supervisors in an large cross border financial institution crisis will likely be to look out for the national treasury, using informational advantages to that effect, notwithstanding MoUs on information sharing and cooperation. A scramble for assets in an large cross-border financial institution crisis is thus likely and would have significant cross-border spillovers, preventing efficient and effective crisis management and resolution. In this set-up, it is natural for national prudential authorities to fear loss of control over domestically-active financial players" (July 2007 assessment of the Eurozone, under Article IV, paragraphs 25 and 26)<sup>14</sup>. Similar findings are highlighted in the IMF Working Paper on EU framework for safeguarding financial stability:

<sup>14</sup> <http://www.imf.org/external/pubs/ft/scr/2007/cr07260.pdf>

<sup>15</sup> IMF Working papers do not represent the views of the IMF; <http://www.imf.org/external/pubs/ft/wp/2007/wp07260.pdf>

towards an analytical benchmark for assessing its effectiveness (November 2007)<sup>15</sup>.

*... but not a sufficient condition*

Should further legal clarity be given to asset transferability, incentives for ring-fencing behaviour would at least be limited. Nevertheless, ring-fencing comes down to Plato's question: "Quis custodiet ipsos custodes?"<sup>16</sup> Consideration should be given as to which authority would prevent banks from transferring assets in crisis situations. Incentives of both home and host authorities are not aligned. In the absence of a common EU regulator, a regulation on asset transferability (e.g. along the lines of the US system) would have to ensure that banks may freely transfer assets provided that regulatory conditions are met. This regulation would have to address the downsides to asset transferability: contagion risk, inadequate protection of shareholders and creditors, etc.. This is the purpose of the sound banking requirements under the US framework.

This approach leaves open those crisis situations where banks do not meet solvency requirements. Even in the US, transfers to undercapitalised banks are prohibited. This issue needs further consideration as part of the Commission services' White Paper on early intervention, and as such does not fall within the scope of this paper. It must be noted that the misaligned incentive structures of home and host authorities in crisis situations (solvency) has led the IMF to suggest the creation of an EU-wide crisis resolution agency.

*The role of asset transfers in terms of crisis resolution would imply further work as part of the 2009 White Paper on early intervention*

**3.2** Experience has shown that share prices may significantly drop in hours, while liquidity and solvency problems generally materialise in days. A framework for asset transferability and crisis management does not make much sense if it is developed separately from a reorganisation framework. The following issues will be part of Commission services' White Paper on early intervention tools for dealing with ailing banks in June 2009:

- Specific early intervention measures by authorities (i.e. administrative authorities, judicial authorities, or supervisors) to allow for a transfer of assets in an ailing bank
- Certain early intervention powers of supervisors may imply the possibility to transfer assets from one entity to another (e.g. transferring or selling assets/liabilities to a healthy bank outside the group; setting up a bridge bank)
- Continuous financing is crucial for banks under intervention. The provision of funding may come from intra-group, external or public sources. For intra-group financing, asset transfers within the group would require the existing cross-border obstacles to be addressed

As long as the authorities do not have the possibility to transfer assets (as part of a groups' reorganisation regime by creating good/bad companies, bridge banks), they will be compelled to resort to ring-fencing (or bail out banks), and apply national resolution tools at each entity level. In contrast, the funding of a residual company to skim off bad assets across entities within a group would imply further harmonisation in view of the current legal obstacles in terms of company law and insolvency law. Consideration would have to be given to introducing a carve-out to company and insolvency law (see section 6.4).

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<sup>16</sup> "Who will guard the guardians?"



*Asset transferability in the context of the possible harmonisation of liquidity supervision*

**3.3** Liquidity is one of the few prudential areas with no or little harmonisation so far. Banks are subject to conflicting rules at subsidiary and branch level. In the area of liquidity risk management, the CRD will require banks to take into account legal, regulatory, and operational limitations to the transferability of liquidity in managing liquidity risk exposures and funding needs across legal entities<sup>17</sup>.

While regulatory requirements to maintain liquidity in various entities and restricting movement of collateral out of them are supposed to limit contagion risk, this also means that firms have to maintain more collateral in the aggregate than they normally would if they were centrally managed. Pools of trapped liquidity increase both operational costs and overall systemic risk as access to liquidity in one jurisdiction to support liquidity needs in another may not be available. This also means that the provision of emergency liquidity assistance may be difficult due to national legal constraints preventing the availability of collateral across jurisdictions.

A framework for asset transferability may help achieve further headway in terms of liquidity supervision. Banks may not only be required to have adequate collateral for intra-group transfers but also for interbank transactions (i.e. liquidity). Certain basic principles could be developed to ensure that banks' liabilities are adequately backed by eligible collateral for central bank operations, should the need arise.

#### **4. WHAT ARE THE MAIN BARRIERS TO ASSET TRANSFERABILITY?**

*The existing barriers in terms of company and insolvency law...*

**4.1** In general terms, legal provisions in company law would block or substantially delay transfers of assets, and insolvency law may retroactively render a transfer null and void. This creates legal uncertainty around such transactions, and may prevent asset transferability from being used as an effective crisis resolution tool. In Annex 2, legal sanctions for breaches of company, civil, banking, criminal and insolvency laws are set out (MS by MS). Other obstacles relating to prior authorisation (board of directors, General assembly) and compliance with the arm length principle were mentioned above in Part 2. Those authorisation regimes would prevent a prompt transfer of assets.

National insolvency law in Member States allows transactions (especially intra-group transactions) to be retroactively ruled void or ineffective if they were carried out during a "suspect period" (Paulian action or other procedures, e.g. in FR). Intra-group transfers of assets in the context of a crisis may also, under certain circumstances, be characterised as transactions detrimental for a transferor or its creditors, and in such circumstances may be prohibited or subject to legal remedies. Under insolvency law, a transfer may be challenged if there was no 'corporate benefit' (e.g. guarantee granted by a subsidiary in respect of its parent's obligation). This can be alleged by an insolvency practitioner or by minority shareholders as an action for 'breach of fiduciary duty'.

In terms of company law, directors are only liable for the operation of their own legal entity and not for the group as a whole. An intra-group transfer of assets is normally considered to be a transaction with a connected party which is subject to additional legal conditions, e.g. application of the arm's length principle. Different types of sanctions are provided in national law when the transfer is deemed detrimental to shareholders or creditors, even if it does not jeopardise the financial condition of the transferor (see Annex 2).

For solvency issues, transfer of assets may be achieved by means of payment of dividends, in which case the mother company would raise the assets to help a distressed subsidiary by up-streaming dividends from another subsidiary within the group. However, this solution may be subject to constraints and delays that could make it ineffective (i.e. administrative steps that the subsidiary needs to fulfil in order to complete the operation of payment of dividends, some countries will be

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<sup>17</sup> Amendment to Annex V of the CRD implementing Basel Committee's sound liquidity risk management principles (September 2008)

subject to limitations as to when and how often dividends can be paid).

*... are constraints reflecting legitimate legal interests (shareholders, creditors)*

The above constraints reflect legitimate legal interests protected by national law and EU company law directives. These legal frameworks aim at:

- Preventing the influence of a company on its subsidiary
- Protecting the independence of the assets of the parent company from its subsidiary
- Protecting shareholders against decisions taken by the board of directors, and minority shareholders against the decisions taken by the majority shareholders
- Preventing any imbalance between the creditors of the company issuing the transfer and those of the company receiving it.

*Only in specific legal regimes, the concept of group interest may allow financial support*

**4.2** Member States' company laws diverge on the extent to which parent companies can instruct their subsidiaries to engage in certain transactions and subsidiaries can consent to transactions that may not be in their own interest. In certain Member States (e.g. Germany), the 'group interest' defined in company law or the definition of banking groups allows for asset transferability (against fair compensation). In countries where company law does not provide for a 'group of company/group interest' framework, compensation for subsidiaries is nevertheless required (responsibility for damages under civil law). [Annex 4](#) provides an overview of national law approaches to 'group of companies'.

The notion of company group can be found in most of the Member States, but only in a few Member States does the notion of company group create rights for the companies belonging to the group. Such is for example the case in HU, CZ and DE. In some Member States (e.g. France) even though legislation does not recognise the group interest, the court may take it into consideration when deciding about the voiding of a transfer that was executed in the interest of the whole group. Financial support, fair compensation and group interest are legal concepts subject to interpretation and case laws. This does not seem to provide a clear framework in stressed situations.

Under CZ law, under a domination agreement (although rarely used), the subsidiary becomes subject to the direct management of the parent company and its interests are subordinated to the interests of the group. In this agreement, the arm's length principle does not apply, and disadvantageous condition is not prohibited. Regardless of any domination agreement, it must be noted that CZ law prohibits any transfers by banks concluded under disadvantageous terms and conditions. This applies in particular to the transfer of assets without economically unjustified consideration or for consideration not corresponding to the value of the assets.

*Banking law seems to be less of an issue*

**4.3** Under national banking laws, supervisors must safeguard the financial soundness of their domestic banks, which could lead to "ring fencing" of local bank's assets. Nevertheless, banking law would not prevent banks' asset transfers if they do not jeopardise the solvency/liquidity of legal entities. Information and prior approval in some jurisdictions (e.g. IT, see section 2.3) does not mean that transfers are prohibited. In many jurisdictions, competent authorities' responsibilities do not extend to assessing the opportunity or feasibility of asset transfers.

*The main obstacle to asset transferability lies in the absence of objective criteria*

**4.4** In most MS laws, in the absence of quantitative or objective criteria, the judge often has a discretionary power to assess the validity of transfers. This holds particularly true for notions such as the 'group's interest' or the application of the "arm's length principle" in stressed situations. The transfer will only be assessed ex-post, and may be retrospectively cancelled.

In addition to the interests already protected by national law and European law, there might be merit in further addressing the following interests in European law:

*allowing for the assessment of the transfer's validity*

- Financial stability might justify, where appropriate, carve-outs in terms of company law subject to a banking reorganisation regime. In particular, time limits (in terms of authorisation of the General Assembly or other bodies) are not necessarily suited to banking, where a crisis rapidly unfolds.
- The group interest with support obligations for both parent and subsidiary. This would imply an adequate banking reorganisation regime in place.

## **5. DEVELOPING A REGULATORY FRAMEWORK FOR ASSET/COLLATERAL TRANSFERABILITY**

*The need for a simple framework tailored to crisis situations...*

5.1 The EFC suggested specific conditions to enhance the legal framework under which banks may transfer assets in crisis situations and thus facilitate crisis management. These conditions included: i) according to the best ex-ante assessment, the banking group as a whole is judged to be solvent; ii) there is a mutual agreement between home and host authorities that a transfer of assets will substantially contribute to resolving severe financial problems in one part of the bank or group without endangering the solvency of other parts and that conditions under which the transfer takes place do not prejudice the position of creditors in home and host Member States.

The Commission services have gathered views and opinions from supervisors. It appears that condition ii) suggested above is expressed in very broad terms and could not be easily implemented in emergency situations, where the ability to act rapidly is critical. A specific supervisory arrangement (i.e. a mutual agreement between authorities) would risk introducing an unworkable restriction on the operation of cross-border banking groups. Supervisors are not best placed to assess the impact of asset transfers in terms of insolvency law and creditors' protection. Besides, such agreement would not be sufficient in itself to prevent the asset transfer from being challenged. Should a supervisor authorise a transfer which would subsequently prove to be detrimental, it could be held liable to depositors/creditors who suffer losses as a result of the transaction.

Requirements must be simple and clear. This means that the transfer of assets should be possible unless otherwise decided by supervisors on grounds of the financial capacity (solvency and liquidity) of all entities within the group. These simple rules may include:

*Including a 'solvency test', definition of eligible collateral, information*

- The definition of a 'solvency test'. In the US, banks must not be critically undercapitalised. As part of the Commission's public consultation, some MS suggested financial protection through a legal mechanism according to which a transfer should not exceed the financial capacities of the transferor or reduce its solvency ratio under a certain threshold. Such a threshold for capital adequacy would support a quick decision in crisis situations. This might be part of Commission's work on early intervention in an attempt to define clearer triggers points for intervention.
- Definition of eligible collateral supporting the asset transfer, and criteria for sound banking risk management (including clarification on the arm's length principle.). This comes down to specifying conditions already set out in the CRD's recital 52, and reviewing the Large exposures regime for intra-group transactions. This regime may be coupled with the harmonisation of the liquidity supervisory framework (See section 3.3);
- Adequate authorisation regimes for crisis management purposes. Sound banking intra-group transaction management might imply ad hoc authorisation regimes where needed by national company law to allow for a quick transfer.
- Information of the supervisory authorities. In some Member States, supervisory authorities must be informed. By way of example, in IT transfers

of assets (en masse) are subject to supervisory authorisation (above 10%) and information (above 5%).

Importantly, the purpose of this framework will not be to tighten up existing Large exposure rules for intra-group transactions, but rather to provide a clear and operational basis for intra-group transfers in stressed situations.

*Collateral requirements seem to provide for an adequate protection*

**5.2** Collateral requirements are the cornerstone of the framework suggested above. By way of comparison, in the US system, intra-group transactions are subject to strict requirements, including in terms of collateral. There are three categories of transactions that may qualify for the exemption: reverse repo, collateralised securities borrowing and secured loan that meets certain requirements. In each of these cases, the affiliate receives funds from the bank and the bank receives securities from the affiliate.

If, following such a transaction, the bank were later to be liquidated following the appointment of the FDIC as receiver for the bank, that liquidation would typically be separate from any bankruptcy proceeding of related companies, and assets and liabilities would typically not be pooled. The assets and liabilities of the bank and any affiliates would not be subjected to any equitable redistribution. As to the rights of the transferor affiliates once the FDIC is appointed receiver, the transferor affiliates receive funds from the bank as part of these transactions in which it transferred securities to the bank. From the perspective of the bank in the event of a bankruptcy of the affiliate transferor, the bank would be at least a secured lender, depending on which category of the "securities financing transaction" the transfer had been.

Where intra-group lending is adequately secured by collateral, MS insolvency law seems to provide for efficient protection. Some stakeholders have suggested that the EU legislation could ensure a preferential right in case of insolvency proceeding subsequent to the transfer with a view of obtaining the restitution or the reimbursement before any creditor, or the assets transferred or an equivalent value<sup>18</sup>. The downside to this approach is that the rights of other unsecured creditors can be circumvented.

Importantly, the granting of a priority right over the assets of the insolvent estate is not a sufficient condition to prevent the transaction from being challenged. Detrimental acts (during the suspect period) can always be challenged<sup>19</sup>.

To enhance legal certainty, further consideration might be given to making intra-group transactions under the framework suggested above, safe from challenge in insolvency proceedings.

## **6. A FRAMEWORK FOR FINANCIAL SUPPORT**

*Any obligations in terms of financial support need further legal clarity of affiliates' obligations*

**6.1** The regulatory framework suggested above would not remove all barriers to asset transferability in terms of company law and insolvency law. A transaction can only be safe from challenge under insolvency and company laws if it is made in accordance with the provisions of those laws, i.e that it does not unfairly benefit a creditor and that it was in the best interests of the transferor company. Unless those transactions are made safe from challenges, a regulatory framework for asset transferability can only partly address these concerns<sup>20</sup>. More importantly, this framework only addresses transfers on an arm's length basis. Financial support (which may include preferential conditions) would imply a complete overhaul of EU company law. The same goes for authorisation regimes which may prevent a timely

<sup>18</sup> it must be noted that this legal protection only work for financial support but does not address capital injection [recapitalisation], as reimbursement of capital instruments cannot precede other liabilities

<sup>19</sup> In that respect, US rules are specific in requiring banks specific procedures and policies requiring a formal approval process when support is provided by a bank, effective policies for obtaining a support... (see Annex 1).

<sup>20</sup> In the US, rules on intra-group transaction (arm-length principle) need to be reconciled with the sound banking requirements (under which procedures for financial support are expected). This is possible under a single company law framework.

transfer.

*A group guarantee does not seem to be an adequate solution*

**6.2.** Some stakeholders have suggested introducing a 'group guarantee' to facilitate asset transferability. Under a group guarantee, the parent credit institution and certain entities of the group could mutually commit to transferring assets in crisis situations (liquidity, solvency facility). This agreement would have to be endorsed by each legal entity being a party to the agreement and endorsed by the board of directors and other relevant body according to national rules. Such agreement would in advance allow for detecting the possible obstacles to transfers.

Such an agreement could be used to show that the company entered into the transaction in good faith, and for the purpose of carrying on its business. But it is less likely to assist in showing that there were reasonable grounds for believing the transaction would benefit the company, since that depends more upon the specifics of the transaction. If the subsidiary had minority shareholders, there would be a possibility that they would challenge any such agreement as unfairly prejudicing their interests. Importantly, this group guarantee does not remove company law authorisation requirements and would not provide a timely transfer, where needed.

*Developing the concept of 'group interest' for financial institutions poses significant challenges...*

**6.3.** As noted above in section 4, the concept of 'group interest' may legally underpin transfers. As provided in most national laws, this would have to be coupled with a fair compensation for the transferor. In particular a possible non compliance with the arms' length principle may also indicate a need for compensation

There is a precedent in the EU legislation. The draft 9th Company Law Directive on the conduct of groups containing a public limited company as a subsidiary was presented in December 1984 for consultation, and removed. Drawing on the DE law, the Directive was intended to provide a framework in which groups are managed on a sound basis whilst ensuring that interests affected by group operations are adequately protected. Particular reference was made to the possibility to transfer assets while protecting the interests of different parties (see Annex 3).

It must be noted that all risks of legal challenges would not be avoided. There might be other areas of allegations (preferences, i.e. a transaction entered into with a person who is one of the company's creditors whereby that person is put into a better position in the event of the company going into insolvent liquidation, transactions at an undervalue...).

From a strict legal point of view, in about half of the Member States, substantial modifications would be needed to establish a 'group interest', while in the other half 'frictions' may occur as well. The banking industry expressed its interest in the notion of group interest but requested further investigation.

*.. and needs to be coupled with further legal obligations for parent undertaking*

Importantly, the 'group interest' concept does not seem to be commensurate with the existing supervisory architecture and MS' responsibility in terms of financial stability. In any case, such a concept would need to be coupled with further legal obligations for parent undertaking, and an appropriate framework in terms of insolvency law.

Any financial support from one entity to another raises the issue as to how failing entities will be treated under a reorganisation regime. By way of comparison in the US, under the cross-guarantee provision of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, parent banks would be held liable, by the receiver of a failed bank, for the failure of FDIC insured subsidiary banks. Losses incurred or anticipated in disposing of or assisting the failed subsidiary may be transferred back to the parent and sister banks. The regulator shall not accept the Capital Restoration Plan unless the parent guarantees that its subsidiary complies with the Capital Restoration Plan for four consecutive quarters and provides adequate assurances of performance.

*For solvency issues, carve-outs in the context of reorganisation measures merit further consideration*

**6.4.** From the development above, it seems that any attempt to further clarify financial support would lead to questions as to how failing entities will be dealt with in insolvency proceedings. By way of comparison, the US approach ('source of financial strength') is based on a comprehensive reorganisation framework (Prompt corrective actions), which does not exist in the EU. In the case of ailing banks, transfer of assets from a group member may be ordered by the special administrators appointed as directors to the bank(s) in crisis. For example in Italy, a single reorganisation plan can be implemented for the whole group. Moreover, a special administrator of the parent bank has specific powers vis-à-vis subsidiaries. It can remove directors, request special administration or liquidation but can not terminate the subsidiaries' financial and management autonomy.

Consideration would have to be given as to whether an EU wide early intervention-reorganisation system might provide carve-outs for transactions executed under a special emergency "early intervention" regime. Intra-group asset transfer to help the ailing group member is presently not part of the reorganisation measures in Member States. Amendments or special banking insolvency rules would be necessary to introduce the possibility of joint reorganisation plans. This would be addressed as part of Commission services' White Paper on early intervention/reorganisations.

## **7. CONCLUSIONS**

*Asset transferability is a double edged sword...*

**7.1.** Addressing legal obstacles to asset transferability is not a policy objective in itself. Most barriers in terms of company law and insolvency law are driven by the protection of legitimate stakeholders (shareholders, creditors). There might be merit in limiting intra-group transfers to limit contagion risks. On the other hand, it is suggested to develop a clear legal framework to allow asset transferability, and to avoid that authorities resort to ring-fencing, in the absence of other alternatives. Section 5 outlines several concrete suggestions in this respect.

*...that needs to be in any case completed by further headways in terms of groups' reorganisation*

**7.1** Any framework for asset transferability would need to be completed by an EU legal framework for banks' reorganisation:

- The distinction between liquidity/insolvency and crisis management/crisis prevention has proven to be useless
- An EU framework for reorganisation/intervention seems to be the adequate legal instrument to provide further safeguards and clarity in terms of insolvency and company law
- Any attempt to clarify the obligations of the parent/subsidiaries would need an adequate legal framework for groups' insolvency (reorganisation)

The Commission's White Paper on Early Intervention tools for dealing with ailing banks due by mid-2009 will address many of these issues in detail.

## Annex 1 - Regulation in the US

Section 23A places four restrictions on transactions between depository institutions and Affiliates:

### 1. The lending double limit rule:

- A depository institution may only engage in "covered transactions" with affiliates where aggregate covered transactions with any one affiliate will not exceed 10 percent of the institution's capital stock and surplus, and transactions with any affiliates will not exceed 20 percent of capital stock and surplus.
- **Specific Exemptions** from the rule for transactions between a bank and its financial subsidiaries:
  - Transactions with financial subsidiaries are only subject to the 20 percent cap on total covered transactions between a bank and its affiliates. These are exempt from the first lending limit, the 10 percent cap that restricts covered transactions between a bank and any one affiliate to 10 percent of the bank's capital stock and surplus.
  - In addition, the United States' Congress created an exception for retained earnings of financial subsidiaries so that parent banks could enjoy those earnings as dividends without restriction.

### 2. The Low Quality Asset restriction:

- A depository institution may not purchase a "low-quality asset" (hereafter "Low Quality Assets") from an affiliate (including from a sister bank) unless the institution, pursuant to an independent credit evaluation, has already committed to buying the asset before the affiliate has acquired it.
- A **specific Exemption** exists from the rule for transactions involving loan participations involving problem loans.
- Section 23A and its implementing regulations define "low-quality assets" as assets falling in any of the following five categories:
  - assets classified by state or federal examiners as "substandard," "doubtful," or "losses", or treated as "special mention" or "other transfer risk problems";
  - assets in nonaccrual status;
  - assets on which principal or interest payments are more than 30 days overdue;
  - assets whose terms have been renegotiated or compromised due to the deteriorating financial condition of the obligor; and
  - assets acquired through foreclosure, repossession or otherwise in satisfaction of a debt previously contracted, if the assets have not yet been reviewed in an examination or inspection.

### 3. The full collateralization requirement:

- All loans or other extensions of credit by a depository institution to an affiliate must be secured by collateral of a certain market value.
- Low-quality assets, securities issued by any affiliate, many securities which may have been issued by the depository institution, most intangible assets and guarantees, letters of credit and other similar instruments are expressly barred from use as collateral in affiliated loans, including those established between sister banks.
- Loans secured by obligations of the United States or its agencies, notes or drafts that are eligible for rediscount by a Federal Reserve Bank, or a segregated earmarked deposit account must be collateralized at 100 percent.
- Loans secured by the obligations of a state or political subdivision of a state, debt instruments, stock, and leases or other property, must be collateralized at between 110 and 130 percent and constitute a perfected security interest.

### 4. The safe and sound banking requirement:

- All transactions between a depository institution and an affiliate, whether they are covered or exempt under the regulations, shall be on terms and conditions that are consistent with safe and sound banking.
- Apart from this restriction, exempt transactions are not otherwise subject to Section 23A.
- What safe and sound banking means has not always been very clear in the past and up to the most recent financial crisis. Guidelines were established by Federal agencies to clarify the concept and what it meant for banks in terms of internal processes. Federal Agencies had to go even further in their clarification exercise - following issues related to funds - and imposed on banks to follow specific procedures when considering entering into transactions. These generally include:
  - Identifying and ensuring the existence of alternative sources of emergency support from the parent holding company, non-bank affiliates or external third parties prior to seeking support from the bank;
  - Putting in place effective policies and procedures for (i) identification of potential circumstances triggering the need for financial support and (ii) implementing the process for obtaining such support;
  - Where support is provided by a bank, including procedures with an oversight process that requires formal approval from the bank's board of directors, or an appropriate board designated committee, independent of the investment advisory function;
  - Implementing an effective risk management system for controlling and monitoring risks posed to the bank - Risk controls should include establishing appropriate risk limits, liquidity planning, performance measurement systems, stress testing, compliance reviews, and management reporting to mitigate the need for significant bank support;
  - Implementing policies and procedures that ensure that the bank is in compliance with existing disclosure and advertising requirements; and
  - Ensuring proper regulatory reporting of contingent liabilities arising out any financial support - in particular notify and consult with the appropriate regulatory body prior to or immediately after (in case of emergency) providing support.
- Safe and sound banking may impose an obligation by a parent bank to bailout its ailing subsidiary.

## 5. Exemptions:

Exemptions to Section 23 A exist but are limited both in scope and in nature. Many exemptions only provide a safe-harbour from the application of the quantitative limits set out above, the "lending double limit rule". There are not exemptions for the safety and soundness requirements. However, some exemptions exist to the low-quality assets and full collateralization requirements. The Section below identifies the different exemptions that apply based on the different types of Covered Transactions and set of circumstances.

Exempt transactions from the (1) "lending double limit rule" only:

- transactions with certain depository institutions and sister banks (where 80 percent of each bank's stock is owned by the same company directly or through a bank holding company);
- conditioned purchases of assets within internal corporate reorganization;
- purchases of securities at a price that is the same as that readily identifiable and routinely quoted on an electronic service.

Exempt transactions from the (1) "lending double limit rule", (2) "Low Quality Asset restriction", and (3) full collateralization requirement BUT not the safety and soundness requirement:

- ordinary correspondent transactions with affiliated banks (including making deposits in affiliate or foreign banks);
- immediate credit to affiliates for uncollected items received in the ordinary course of business;
- transactions that are fully secured by federal securities, federal guarantees or cash deposits;
- assets purchased by newly formed bank and authorized by a Federal Agency;



- assets purchased at a price that is the same as the readily identifiable and publicly available market price;
- certain purchases of securities issued by Affiliated service companies;
- transactions implemented within the context of a merger between two deposit institutions and permitted under the Bank Merger Act;
- conditioned intraday extensions of credit;
- conditioned purchases of nonrecourse loans from Affiliate;
- purchase of municipal securities;
- buybacks of loans originated by the depository institution and sold to any of its affiliates subject to repurchase agreements or with recourse;
- current crisis related transactions as developed under section 4.2.1 below;
- Current crisis related purchases of asset-backed commercial paper from mutual funds.

The Federal Reserve Board may grant further exemptions for Covered Transactions or relationships "at its discretion ... if it finds such exemptions to be in the public interest and consistent with the purposes of" Section 23A. It may do so in response to a specific request made by a member bank

**Section 23B places additional but qualitative restrictions on transactions between depository institutions and their affiliates:**

- **The arm's length requirement.** In general, transactions between depository institutions and affiliates must be conducted on an arms-length basis, i.e., on terms and in circumstances (including where credit standards obtain) that are no more favourable to the institution than those for comparable transactions involving non - affiliates.
- Section 23B also contains **three outright prohibitions:**

**1. No Purchase from Affiliates as a Fiduciary.** Depository institutions and their subsidiaries are barred, when acting as fiduciaries, from purchasing securities or any other assets from affiliates unless such purchases are permitted under a trust instrument, by court order or by state law.

**2. No Acquisition of Securities Underwritten by Affiliate:**

- Banks and thrifts and their subsidiaries may not knowingly acquire securities issued during a public offering if the principal underwriter of the securities is an affiliate.
- This restriction can be waived, however, by a majority of the bank's directors, upon determining that the purchase is a sound investment for the bank, irrespective of the fact that a bank affiliate is the principal underwriter. This does create corporate governance issues, however, in the sense that in such cases interlocking directors in the bank and its subsidiary are allowed to vote when corporate governance principles would require that they abstain.

**3. No Advertised Assumption of Responsibility for Affiliate Obligations.** Banks and their subsidiaries and affiliates are barred from publishing advertisements or entering into any agreement stating or suggesting that the bank is responsible for the obligations of its affiliates. However, making references to authorized guarantees, letters of credit or cross-affiliate netting arrangement is permitted.

## Annex 2 - Sanctions according to national law

State	Civil Law	Insolvency Law	Company Law	Banking Law	Criminal Law	Others
AT	<ul style="list-style-type: none"> <li>-held personally liable for damages or outstanding arising</li> <li>-liability of the directors toward creditors</li> <li>-liability of the managing directors (and /or the shareholders)</li> </ul>	<ul style="list-style-type: none"> <li>-Null and void</li> <li>-unenforceable</li> <li>-return to the estate</li> </ul>	<ul style="list-style-type: none"> <li>- managing directors are jointly and severally liable towards the company for any damage resulting there from</li> <li>-personal civil liability for the directors and constitutes a criminal offense</li> <li>-liable for payments</li> <li>-shareholder liability in exceptional circumstances</li> </ul>	<ul style="list-style-type: none"> <li>-administrative fine of up to EUR 50,000.</li> </ul>	<ul style="list-style-type: none"> <li>-liability of the directors of the company</li> <li>-from six months to ten years imprisonment</li> <li>- preference of a creditor is sanctioned with a maximum of two years imprisonment</li> <li>- gross negligence leading to the insolvency and the gross negligent disregard of creditors' interests are sanctioned by imprisonment of up to two years</li> </ul>	<ul style="list-style-type: none"> <li>- for instance, theft, fraud, breach of trust</li> </ul>
BE	<ul style="list-style-type: none"> <li>-Action for fraud</li> </ul>	<ul style="list-style-type: none"> <li>-can be annulled</li> </ul>	<ul style="list-style-type: none"> <li>- fiduciary duties of directors</li> </ul>		<ul style="list-style-type: none"> <li>-Breach of confidence</li> </ul>	
CZ		<ul style="list-style-type: none"> <li>- The following transfer of assets can be challenged by the insolvency trustee within insolvency proceedings</li> </ul>	<ul style="list-style-type: none"> <li>-the transfer of assets is null and void and the transferred assets have to be returned to a transferor</li> <li>-the board members of the transferor not comply with their duty to act with due managerial care,</li> </ul>	<ul style="list-style-type: none"> <li>- members of the statutory body of a bank who have infringed their duties as members of the statutory body of the bank ensuing from the legal rules or from the Articles of</li> </ul>	<ul style="list-style-type: none"> <li>-only on natural persons</li> <li>-board members of the company transferring the assets can be found guilty of certain crimes</li> </ul>	

State	Civil Law	Insolvency Law	Company Law	Banking Law	Criminal Law	Others
			<p>they can be liable for any damages incurred to the company</p>	<p>Association shall be liable jointly and severally for any damage caused to the creditors of the bank resulting from the bank not being able to meet its due commitments as a result of the infringement of duties by those members of the statutory body,</p> <p>- if the supervisor detects shortcomings in the activities of a bank it shall be entitled according to the nature of the shortcoming to demand specific remedial measures and sanctions, e. g. replacing persons in the management of the bank, replacing members of the</p>		

State	Civil Law	Insolvency Law	Company Law	Banking Law	Criminal Law	Others
				<p>bank's supervisory board, adopting stricter rules for creating provisions for the bank's assets and reserves or for determining capital requirements, creating adequate provisions and reserves, maintaining capital above the threshold stipulated in the Act on Banks, imposing a fine of up to CZK 50,000,000, it is also entitled, e. g., to prohibit or restrict the execution of transactions with legal entities which have close links with the bank or which belong to the same consolidated group as the bank or which</p>		

State	Civil Law	Insolvency Law	Company Law	Banking Law	Criminal Law	Others
				have a special relation to the bank, or in case of serious shortcomings to withdraw a banking licence		
DE	-a creditor of transferor can contest the transfer of assets	-Can be annulled	-directors are liable for the damage -parent company may be liable for undue influence over subsidiary	-directors which are responsible are liable -creditors can sue on illegal transactions	-infidelity in accordance with sec. 266 criminal code	
DK		-the tax authorities will make the allocation Can be annulled	-nullity of the transfer -the shareholders can decide that the company should file a writ of summons against the management -management is liable for negligence	-prison sentence or fine	-liability of the directors of the company Broad variety of offences against property	
EE		-failure to perform the obligation to submit a petition in bankruptcy provided by law is punishable by a pecuniary punishment or up to one year of imprisonment	-members of the management board shall solidarity compensate to the public limited company any payment made by the public limited company after the insolvency of the company became evident and were not made with due	No specific sanction	-the debtor assumes unjustified obligations -pecuniary punishment or up to 3 years' imprisonment	

State	Civil Law	Insolvency Law	Company Law	Banking Law	Criminal Law	Others
ES	-action for fraud	-no sanctions	diligence -no specific sanctions	-termination or amendment to contracts may be required but no specific sanction	-directors can be sanctioned for fraud	
FR	-Substitution of creditor in rights of debtor -Annulment for fraud	Cancellation during suspect period Fraud	-liability for the debts of the company -acts agreed after the cessation of payments: transfer considered as void -nullity of the agreement -executive's liability -compensation for damage caused to the company Compensation for damage caused to third parties		-the sanction for a misuse of company assets/property is a prison sentence of five years and a fine of 375.000 Euros	-action addressing liability for excess of liabilities over assets -action addressing liability for the debts of the company -the company manager/s may be compelled to bear the debts of the legal entity, in whole or in part
HU	-contracts in violation of legal regulations and contracts concluded by evading a legal regulation shall be null and void	-the creditor may file for legal action before the court within 90 days from the time of gaining knowledge or within one year from the date of publication of the notice of liquidation to contest concerning -the liquidator shall	-Liable for damages caused to third parties by its executive officer when acting in an official capacity - if damage is caused by several persons together their liability shall be joint and several -liability of executive officers	-responsibility of the board members and the supervisory board members -Supervisor can create restrictions on transactions -range of sanctions depending on the irregularities	-Violation of Accounting Regulations -Criminal Bankruptcy -Concealment of Assets for Avoiding a Liability -Credit Fraud -Impairment of Equity Capital -Failure to Comply with the Obligation	

State	Civil Law	Insolvency Law	Company Law	Banking Law	Criminal Law	Others
		have powers to annul, with immediate effect, the contracts concluded by the debtor	for damages to the business association if the damage results from a decision of the management body -liability of the management board for any payment made due to its failure to make the statement or to making a false statement according to the general provisions pertaining to executive officers	committed by the bank -limit or prohibit the credit institution -fines and penalties for any violations of the provisions stipulated in the legal regulations -responsibility of the supervisory commissioner	to Supply Economic Data -Capital Investment Fraud -Money Laundering -Failure to Comply with the Reporting Obligation Related to Money Laundering -Embezzlement -Fraud -Misappropriation of Funds -Defalcation	
IT	-Liability for damages	Liability for damages and criminal liability	Liability of directors for breach of fiduciary duties	-administrative sanctions imposed by the competent supervisory authority	-Liability for damages and criminal liability	
LU	-the directors can be declared liable based on the general tort liability principles	- Can be annulled - Extension of the bankruptcy to the directors - Action in « <i>comblement de passif</i> »	-the directors shall be liable towards the company -jointly liability of the directors	-the CSSF is empowered to require the credit institution to put an end to the irregular situation -CSSF can create restrictions on transactions	-no liability of a legal entity but the natural person will be personally liable	-could result in a new assessment of the taxable basis of the involved companies -the non-deduction of certain charges -the re-characterization of certain advantage

State	Civil Law	Insolvency Law	Company Law	Banking Law	Criminal Law	Others
NL	-obligation to compensate damage based on tort liability	-action for fraud - Can be annulled in case of demonstration of prejudice	-a director can be held liable to their company	-administrative sanction but not to exceed €900,000	The mere fact that a legal entity goes bankrupt, even in the event of bad administration that can be imputed to an individual, does not constitute a criminal act -potential liability of the directors of the company	considered
PL	- Unconscionable transactions ineffective vis-à-vis creditors. - theoretical possibility (suggested by legal commentators, but untested in practice) of liability in tort of a dominant company for damage caused by an abuse of dominant position either to the subsidiary or to its creditors.	-Can be annulled - the ineffectiveness vis-a-vis the bankruptcy estate of certain transaction effected in the « suspect period »	-civil liability of the members of the management board of that entity towards the company - If such damage has been caused by several persons jointly, they shall be jointly and severally liable for such damage	-nullity of the related transaction - the termination and/or amendment of contracts entered between the bank and entities operating in the same holding (group) and other closely linked entities Directors can be personally fined.	- If such damage has been caused by several persons jointly, they shall be jointly and severally liable for such damage with penalty of imprisonment for up to 5 years and/or a fine - criminal liability of an individual who, while under the duty to manage property-related (patrimonial) affairs or the economic activity of other individual, legal person or an entity without	



State	Civil Law	Insolvency Law	Company Law	Banking Law	Criminal Law	Others
					<p>legal personality, has caused significant damage to such individual, person or entity through his/her abuse of power or non-performance of such duty.</p> <p>- criminal liability in the following instances :</p> <p>providing misleading information in order to obtain financial assistance;</p> <p>asset-stripping in light of impending insolvency or bankruptcy;</p> <p>preferential treatment of certain creditors in light of impending insolvency or bankruptcy;</p> <p>abuse of a distressed situation of another person to obtain a disproportionate benefit</p>	
PT	-liability of a company manager and/or director in	- all acts performed in the four previous years to an	- liability of directors to the company	-Supervisor can create restrictions	- imprisonment penalty or with a fine not exceeding	

State	Civil Law	Insolvency Law	Company Law	Banking Law	Criminal Law	Others
	what concerns its liability before a company's shareholder or third parties	insolvency procedure can be annulled in order to allow that the assets subject to those acts can be affected to the assets belonging to the bankruptcy assets (" <i>massa insolvente</i> ")	- Liability before the company's shareholders - Liability before the company's creditors - Liability before the company's employees	where risk to solvency or liquidity ratios -fines are possible	600 days if the insolvency situation occurs and its recognized in a judicial proceeding.	
RO	- annulment of arrangements entered into by the debtor with the aim of lessening their rights, by a so called "revokatory action"	-civil or penal sanctions - criminal offence the deed of a person who, with the intention to fraud the creditors, alienates a part of the assets of an insolvent borrower. - Transfers of assets made with the aim of defrauding the creditors may be annulled	-criminal liability for the founder, the manager, the director, the executive director or the legal representative of the company	- the National Bank of Romania may decide on the suspension of the exercise of the voting rights attached to the shares held by the shareholders or members in question - The National Bank of Romania may adopt or impose penalties against credit institutions, Romanian legal entities, or against persons who effectively control the business of credit institutions, that infringe laws,	-1 to 5 years of jail a person who, mens rea, brings losses while administrating the assets of another.	-fine, criminal charges and confiscation of assets

State	Civil Law	Insolvency Law	Company Law	Banking Law	Criminal Law	Others
				regulations or administrative provisions concerning the supervision or pursuit of their activities, and/or measures aimed specifically at ending the observed infringements or the causes of such infringements.		
SE		- the transfer may be annulled	-the director is liable to compensate the limited liability company for the damaged caused		-liability of the directors of the company	-damages to the trade union (maximum SEK 500,000)
UK	- Actions in tort possible	- Claw back provisions for suspect transactions	- Sanctions for breach of director fiduciary duties - Corporate veil can be pierced under exceptional circumstances	- Fines for non compliance with regulations	- Criminal liability for directors	

Source: National reports (BBB law)

## Annex 3 - 9<sup>th</sup> company law Directive

The *aim* of the 9th Company law directive proposal was to provide legal certainty for groups by recognising that the collective interest of the group may take precedence over that of their member companies. The proposal found a common description for the notion of "group": an economic unit consisting of independent legal bodies administered according to a common strategy.

The pursuit of the common strategy may however result in one company's growth potential being restricted to avoid damaging the position of another company, or in *liquid assets being transferred from one company to another in the interest of the group*. While such transactions may be justified or necessary in economic terms, they are in contradiction with the basic principles of company law i.e. companies are autonomous not only in legal but also in economic terms, and must act in their own best interest.

The two fundamentally different elements of a group from individual companies:

1. The information must extend to companies other than that in which the shareholders, creditors and employees have rights.
  2. Transactions between the members companies of a group (transfer of financial resources and provisions of goods and services) are internal i.e. they are not visible from the outside.
- To avoid abuses legal remedies are available.

### Liability of directors:

Giving legal status to a group would imply giving the group management the power to impose its administration and commercial policy on its subsidiaries. The managers of the subsidiaries will be obliged to follow these instructions even where the subsidiary will thereby incur financial losses (e.g. closure of profitable services). These managers must therefore not be held liable vis-à-vis their own companies.

### Protection of minority shareholders:

Two safeguards may be implemented:

1. Purchase of their shareholdings for cash or exchange them for the shares of the parent company.
2. Guaranteed income on the minority share independent of the performance of the subsidiary.

### Protection of creditors:

Creditors are primarily protected by the disclosure of group relationships and the publication of consolidated accounts. Parent companies may also issue letters of comfort, letters of intent, or establish sponsorships. If creditworthiness of the subsidiary can not be improved, parent company can be made liable for the debt of the subsidiary. Liability would be incurred only if the subsidiary was itself no longer able to honour its commitments. (Mother is not joint and several but secondary debtor.)

## Annex 4 - The notion of group in Europe

The notion of group in Europe					
State	Group	Group interest Yes/No/Indirectly	Comments	Law/ Case law	Arm's length principle
AT	Y	N		–	
BE	Y	Indirectly	offence of misuse of assets not constituted	Case law	Indirectly
CZ	Y	Y	Domination Agreement	Law	Specific condition
DE	Y	Y	Control /profit transfer agreement	Law	Specific condition
DK	Y	N		–	N
EE	Y	N	case-law is not sufficient		N
ES	Y	N		–	N
FR	Y	Indirectly	misuse of corporate property not constitute	Case law	Indirectly
HU	Y	Y	control contract	Law	Specific condition
IT	Y	Indirectly			Indirectly
LU	Y	No?	controversial		N
NL	Y	Indirectly		Case law	Indirectly
PL	Y	No		-	N
PT	Y	Indirectly		Case law	N
RO	Y	Indirectly	Penal excluded		Indirectly
SE	Y	N			N
UK	Y	No		-	N

Indirectly = Most of the time penal sanctions but liability or financial consequences

Specific condition = may adopt resolutions binding upon the operation of the controlled company

Source: National reports (DBB law)