Erhvervsudvalget 2010-11
ERU alm. del Bilag 178
Offentligt

MINISTER FOR ECONOMIC
AND BUSINESS AFFAIRS

European Commission
DG Internal Market and Services
Rue de Spa 2
B-1049 Brussels
Belgium

MINISTRY OF ECONOMIC
AND BUSINESS AFFAIRS
Slotsholmsgade 10-12
DK-1216 Copenhagen K

Tel. +45 33 92 33 50
Fax +45 33 12 37 78
CVR no. 10 09 24 85
oem@oem.dk
www.oem.dk

Commission consultation on technical details of a possible EU framework for bank recovery and resolution

To the European Commission

General remarks

The financial crisis has shown that dealing with distressed credit institutions is a major challenge. Across Europe different rescue packages and resolution schemes have been put in place to ensure financial stability. The importance of an effective crisis management system is now being addressed by the Commission to ensure sufficient schemes in all member states to cope with distressed credit institutions in the future.

We strongly support this initiative since a harmonised resolution approach which covers all member states is required in order to ensure a level playing field in the EU. The current situation with various ad hoc solutions across member states hampers transparency and market efficiency.

Denmark has already established a credible resolution regime providing for an orderly wind-up of distressed banks having dismantled a general state guarantee and put in place a resolution scheme in autumn 2010. The objective of the resolution scheme is to safeguard financial stability and to minimise economic losses when a bank becomes unable to meet the statutory capital requirements.

The new scheme allows for potential losses to senior creditors and depositors as well as shareholders and subordinated debt while maintaining a going-concern organisation. The resolution mechanism creates incentives for holders of large deposits and other non-deposit creditors to monitor banks. By reducing the risk appetite of banks the mechanism leads to a sounder financial system.

The new scheme was tested for the first time during the weekend of 4-6 February 2011 when Amagerbanken A/S was taken over by the Danish

Financial Stability Company. Creditors including depositors whose net deposits with Amagerbanken A/S are in excess of EUR 100.000 must anticipate immediate losses of approximately 41 per cent as the bank is liquidated (for further information see annex II). Customers normal banking business (e.g. use of credit cards, debtor cards etc.) were not affected. The bank opened as usual Monday morning with no apparent difference for the customers, who can still conduct normal banking business.

Market reactions have been limited towards the functioning of the Danish resolution mechanism and how it was used on Amagerbanken A/S. However, recently the long term ratings of banks incorporated in Denmark have been downgraded by Moody's as they lowered their assessment of the likelihood of future public support and, hence, the systemic support uplift they had applied previously. This rating action was initiated after the Danish resolution regime was used for the first time on Amagerbanken A/S.

As a consequence we see the creation of more uniform resolution schemes across the EU as crucial in ensuring an effective single market in banking. The Danish scheme - which is broadly in line with the principles in the Commissions consultation document - shows that it is possible to take rapid and decisive action in order to wind-up failing banks and avoid contagion to the general banking system.

Central issues

Five general points on central issues are raised in the following. Please find our detailed comments to specific sections in annex I.

Scope

As for the scope of the resolution regime we agree that the regime should cover all credit institutions. However, there should be a measure of proportionality in relation to smaller financial institutions with no cross border activities in order to avoid excessive administrative burdens. Furthermore, we support the work by the Commission in considering which crisis management arrangements might be necessary for other types of financial institution.

Furthermore, it should be pointed out that the Danish legislative framework offers an alternative to ordinary liquidation. For the system not to be expropriatory and conflict with fundamental principles it is voluntary for the credit institution which can always choose a normal insolvency procedure. We believe that the same approach should be taken at EU level.

Asset transfers

We support further work on a European framework on asset transfers to support financial stability and to prevent and mitigate financial crisis

situations while at the same time assuring legal certainty and minimizing contagion risk between companies in a group.

However, transfer of assets intra-group can contain a risk of contagion (abuse of a dominant position). Our statutory practice to prevent contagion requires a prior permission from the supervisor to the financial institution before transfer of assets (exposures) upwards and side wards in a group is allowed. Recent experiences have illustrated the usefulness of a regime requiring prior supervisory approval of intra-group exposures in avoiding contagion. Avoiding contagion is in our opinion as important as facilitating intra-group financial support. This is especially the case as long as there is no effective cross border crisis resolution framework in the EU and no agreement on possible burden sharing among member states in crisis situations. Until an effective cross border recovery and resolution framework is in place it is very important for us to be able to maintain these tools.

Debt write down
A transparent and credible possibility of debt write down will be necessary to ensure that creditors of especially large credit institutions will do a thorough analysis of the credit risk before lending to a credit institution. The financial crisis showed that the possibility of losses for shareholders was not sufficient to discipline the behaviour of credit institutions. Therefore broader measures are needed such as the possibility of debt write down. In addition it is also necessary to ensure resolution of a credit institution without government intervention. With a debt write down the credit institution can continue its business to the benefit of the economy.

The comprehensive approach is preferred since it is at least as attractive as the alternative (i.e. liquidation) to creditors. This is important because otherwise there will be creditors who would have been better off in a liquidation process and consequently hold the management or the resolution authority responsible for their loss. Furthermore, this approach works in all circumstances since - contrary to the targeted approach - there is no upper limit to the write down.

It should be noted that if a debt write down applies to shares or existing debt issued before entry into force of the power such write down could be expropriatory and a compensation mechanism would be necessary.

Finally, we find that there must be no doubt that holders of covered bonds and junior covered bonds always will receive timely payment. Holders of covered bonds shall according to CRD and UCITS benefit from a privileged status in case of bankruptcy and holders of junior covered bonds do also benefit from such a status. It should therefore be made clear that covered bonds and junior covered bonds should not be subject to debt write down.

Financing

We strongly support that member states should be able to meet financing requirements for the resolution regimes through the existing structure of the deposit guarantee schemes in order to exploit synergies. The compatibility of such an approach with staid aid rules should be made clear.

As for the target size and the phasing in of the fund it is necessary to take into account the various other regulatory initiatives under way, e.g. capital and liquidity requirements, as well as the revision of the directive on deposit guarantee schemes. Too strict financing requirements in the new resolution regime may risk affecting the real economy in member states. Furthermore, an appropriate balance between ex ante and ex post financing is necessary.

Derogations from basic legal principles

Derogations from national basic legal principles cause uncertainty and reduce transparency. Derogations should therefore be avoided or limited to the largest extend possible. This applies to company law, bankruptcy law and general principles of liability and judicial recourse. Especially derogations from national bankruptcy law may cause uncertainty and lack of transparency which can have a negative impact on the credit institution's funding possibilities. This is not in the interest of financial stability and such derogations should therefore be considered very carefully.

Yours sincerely,

Brian Mikkelsen

Annex I: Detailed comments

Scope of preparatory and preventive measures and resolution tools (Part 1)

As for the scope of the resolution regime we agree that the regime should cover all credit institutions. However, there should be a measure of proportionality in relation to smaller financial institutions with no cross border activities in order to avoid excessive administrative burdens. Furthermore, we support the work by the Commission in considering which crisis management arrangements might be necessary for other types of financial institution.

Authorities responsible for resolution (Part 1 – question box 3)

We support that the designation of the administrative authority to apply the resolution tools and exercise the resolution powers should be left to national discretion. Some member states already have different kinds of frameworks and it should be possible to build upon these.

As long as the credit institution fulfils the capital requirements we find that the main responsibility should stay with the supervisor. This implies that some of the responsibility for the resolution plan rests within the supervisor and not with the resolution authority.

Furthermore, it should be considered if it is possible to create a clearer distinction between “living credit institutions” and "near death credit institutions", where the supervisor has set a deadline for the fulfilment of the capital requirement. As long as the credit institution is a “living credit institution” the responsibility for the institution rests with the supervisors. The resolution authority needs to get involved if the credit institution is a “near death credit institution”.

That is also the approach in the Danish framework where the Financial Stability Company takes over the “near death credit institution” meaning an institution which no longer fulfils the capital requirements and where the supervisor may revoke the license.

Supervision (Part 2.A. – question box 4)

In general we welcome a reinforcement of the supervisory regime with regard to supervisory planning and forward looking risk assessment.

Stress testing is a key management tool in financial institutions and should be well-integrated. It is also a very useful supervisory tool among others. We believe stress tests should be conducted both by supervisors and by all financial institutions on a frequent basis. Stress testing by supervisors allows for a cross-sectoral view of the resilience in financial institutions and is a backbone in the supervisory review evaluation process and dialogue. Institutions must observe and incorporate stress test re-

quirements in a proportionate manner to reflect the nature, scale and complexity of the activities.

We welcome further convergence at EU level on the general principles of national stress testing exercises. However, it is important to leave a room for national discretion as regards the sample, scope and relevant macroeconomic scenarios. We see merits in closer cooperation on stress testing within supervisory colleges.

We acknowledge that occasional disclosure of stress test results in relation to individual financial institutions can be a possibility under extraordinary circumstances as disclosure might contribute to restore confidence in financial markets. Proper back stops mechanisms, i.e. effective resolution frameworks, must be in place and communicated to the market if stress test results are disclosed.

Recovery planning (Part 2.B. – question box 7)
It is proposed that credit institutions should develop and maintain recovery plans detailing how an institution and its activities might be dismantled and wound up rapidly and in an orderly manner.

We agree that recovery plans could be developed subject to proportionality principles and a careful assessment of the costs and benefits. It should be noted that the recovery plan may not be exhaustive in a crisis situation. Furthermore we find that the need for group recovery plans should be further assessed. The entity specific recovery plan might be sufficient to make an assessment of the group recovery plan.

We support that the management of the financial institution shall take all necessary steps to avoid financial difficulties. There must be no doubt that this is the responsibility of the management. The management must make its decision after collecting all necessary updated and available information. However, it shall not be sufficient automatically to fall back on previously adopted policies and recovery plans even if these may be included in the box of instruments that the management will look to in case of financial difficulties or crises.

Generally lack of responsibility increases the risk of moral hazard. Therefore the management of the institution should not by regulation be released from its responsibility and certainly not on the grounds that the management simply has followed the previously adopted policies and plans.

Intra-group financial support (Part 2.C. – question box 9-17)
We support further work on a European framework on asset transfers to support financial stability and to prevent and mitigate financial crisis situations while at the same time assuring legal certainty and minimizing contagion risk between companies in a group. There is a need to look into

best practices on how to regulate intra-group exposures and transactions. In some situations transfer of assets should be limited and in other situations transfer of assets should be encouraged.

Distinct and clear liabilities on each financial institution in a group will contribute to transparency. Introducing intra-group liability may have advantages in some situations but will cause uncertainty and reduce transparency in other situations. This applies both to groups that operate nationally and across borders.

Transfer of assets intra-group always contains a risk of contagion (abuse of a dominant position). Our statutory practice to prevent contagion requires a prior permission from the supervisor to the financial institution before transfer of assets (exposures) upwards and side wards in a group is allowed. Generally intra-group exposures will be accepted by the supervisor up to a limit of 25 per cent of the capital requirement plus the amount of surplus capital of the lender. The supervisor may raise or lower this limit based on an individual evaluation of the risk. In addition all intra-group transactions (including exposures) must be based on market terms.

Recent experiences (also during the financial crisis) have in our opinion illustrated the usefulness of a regime requiring prior supervisory approval of intra-group exposures in avoiding contagion. Avoiding contagion is in our opinion at least as important as facilitating intra-group financial support. Therefore, it is very important for us to be able to maintain these national requirements and we suggest that a future EU framework for bank recovery and resolution should be inspired by this regime.

On a specific note we find it necessary and crucial that the entity specific authority has the power to refuse transfer of assets to other entities in the group. The decision from the entity specific authority must be based on good and justified grounds. It will be in contradiction with general legal principles (legal entities are responsible for own debt) in Denmark to introduce the concept of group interest and we are not convinced that the advantages hereof will exceed the disadvantages.

Furthermore, as mentioned in the general comments derogations from national bankruptcy law may cause uncertainty and lack of transparency which can have a negative impact on the funding possibilities of credit institutions. Such uncertainty thus risks undermining financial stability.

As for the decision to engage in a transfer of assets there must be no doubt that the management body of each institution is responsible for its decisions. Public authorities may require the end to a certain behaviour or activity as well as impose requirements that must be met by the institution. According to CRD higher capital requirements can be imposed by the supervisory authority on the financial institution. However, it should

be the responsibility of the management body to decide how to meet the demands and requirements from the authorities.

If demands or requirements are not met the relevant authority may use the instruments they are given by the law including replacing the management and revoking the license of the financial institution. However, it seems to be in contradiction with legal principles if a public authority is authorized to assume management power over an institution including ordering transfer of assets between two separate legal entities.

We agree that it will be useful to require the financial institutions to adopt politics or plans that may be used in case of financial difficulties or imminent crises. But it will be almost impossible in advance to foresee which actions by the management will be appropriate in case of financial crises or difficulties in a group. Therefore, we do not find that the resolution plan or financial support agreement should be legally binding on the institutions.

If it nevertheless is decided that the resolution plan or financial support agreement should be legally binding on the institution it is necessary to consider that a group financial support agreement should be approved by the shareholders' meeting. However, it is unclear which quorum or majority would be required in order for the agreement to be approved. This question is rather critical if there are minority shareholders in any of the relevant companies as the financial support could potentially, it seems, favour the majority shareholder (the parent company) at the expense of any minority shareholders and such a decision could therefore depending on the circumstances require a unanimous decision at the shareholders' meeting according to the current rules in some Member States, including in Denmark.

It is therefore relevant to consider whether national legislation on quorum and, in particular, majority requirements should apply when the management proposes to the shareholders to enter into agreements on intra group financial support or whether a harmonised set of EU rules should apply. It could be relevant to map the rules in the different Member States to get an overview on the current situation in this respect.

Resolution Planning (Part 2.D. – question box 21)
The Commission proposes that the resolution authorities - in consultation with supervisors - should be required to draw up and maintain resolution plans for each credit institution for which they are resolution authority. Credit institutions should supply information necessary for the drawing up and maintenance of resolution plans on the request of the resolution authority. We would welcome further clarification on how the institutions are involved in the development of the resolution plan.

As mentioned above we find it should be considered if it is possible to create a clear distinction between “living credit institutions” and "near death credit institutions" where the supervisor has set a deadline for the fulfilment of the capital requirement.

Furthermore, the concept of group level resolution authorities and the need for group resolution plans must be further assessed. The most relevant plan must be the plan for the bank itself. That is where all the activities are (the assets, liabilities, the depositors etc.).

Finally, we are concerned about the distribution of responsibilities between resolution authorities and supervisory authorities. We find that the proposed preventative powers intervene with the normal functioning of the supervisory process. Such powers should exclusively be applied by the supervisory authority. A way to solve this issue would be that resolution authorities would propose to supervisory authorities the imposition of a list of measures to remove the impediments to an effective resolution.

Early Intervention (Part 3.E. – question box 24-27)
We are generally supportive of extending the circumstances in which the supervisory powers of early intervention may be exercised. We find the triggers sufficiently flexible.

We do not see the necessity of appointing a special manager. We find that the tools where the supervisor can require the credit institution to replace one or more board members or managing directors or require their dismissal strike an appropriate balance in this respect. Furthermore, it should be considered that such a tool would be a derogation from the normal company law framework (outside the insolvency/-resolution phase) where such issues are left to shareholders and management to decide. It should be noted that such a measure could be considered expropriation of shareholders’ rights and thus could activate special constitutional rights in Member States.

We find that the consolidating supervisor should be responsible for assessment of group level recovery plans and where necessary an agreement on group level should be reached within the supervisory colleges. Supervisors should strive for a joint decision on the implementation of a group recovery plan. In case of disagreement supervisors should be able to refer the matter to the EBA but the EBA decision should not be binding on the supervisors involved. The suggested timeline (24 hours) for decisions by the consolidating supervisor and the mediation authority seems too short.

Resolution: Conditions, objectives ad general principles (Part 4.F. – question box 28)
The Commission proposes that the resolution authorities should apply the resolution tools and exercise the resolution powers when a credit institution is failing or likely to fail and the conditions for resolution are met.

Again we would refer to the need for a clear distinction between "living credit institutions" and "near death credit institutions". The triggers for resolution should follow this distinction.

Specifically, we support option 3 which seems to be the most appropriate trigger as it is a purely quantitative capital trigger. However, we find that the trigger needs to be adjusted to specify that the trigger point is where the bank no longer possesses sufficient tier 1 instruments as required under chapter 2 of title V of the CRD to meet the requirement of Article 75 of the CRD.

We believe the trigger condition of "likely to fail" can create too much uncertainty. We suggest therefore that the approach should be that the credit institution notifies the supervisor that it is failing or likely to fail. This notification means the supervisor sets a deadline to the credit institution to fulfil the requirements. If this requirement has not been met by the credit institution the supervisor shall revoke the institution's license and the credit institution must be resolved under the responsibility of the resolution authority.

We find that the general principles governing resolution seem appropriate. We attach importance to the principle that creditors of the same class are treated in a fair and equitable manner and that no creditor incurs greater losses than would be incurred under liquidation. Furthermore, we find it necessary to require independent valuation in the resolution process.

Resolution tools and powers (Part 4.G. – question box 31)
We find that the resolution framework should cover a broad range of tools in order to enable member states to address a specific crisis most effectively. We find the proposed resolution tools sufficiently comprehensive to allow resolution authorities to deal with a credit institution which needs to be resolved.

However, we would welcome further guidelines regarding when the use of these tools is considered as being in compliance with the Treaty and state aid rules.

In order to ensure a level playing field and to facilitate smooth cooperation between authorities we agree that resolution tools should as far as possible be harmonized at EU level. However, this should not prevent

member states from supplementing the EU resolution framework with national tools and powers.

We find that the power to take control over the affected credit institution must be considered carefully and it must be considered in connection with the assessment of the scope of this framework and the distinction between supervisors and resolution authorities.

It should also be pointed out that the Danish legislative framework offers an alternative to ordinary liquidation. For the system not to be expropriatory and conflict with fundamental principles it is voluntary for the credit institution which can always choose a normal insolvency procedure. We believe that the same approach should be taken at EU level.

Finally, we find that there must be no doubt that holders of covered bonds and junior covered bonds always will receive timely payment. Applying resolution tools must not jeopardize this objective. Assets which serve as collateral for holders of covered bonds and junior covered bonds should therefore not be affected by resolution or recovery. We suggest that this special treatment of covered bonds is explicitly taken into account in part G and when designing the appropriate resolution tools.

Partial transfers: Safeguards and compensation (Part 4.H. – question box 46-51)

The Commission approach is based on the presumption that the enforcement of close-out netting or security rights may be stayed if a decision of a resolution is taken.

Should this be the case we find it important that all or none of the transactions/securities comprised by a netting agreement and/or financial collateral agreement should be included in the stay and that safeguards are applied accordingly. A solution where transactions entered into or securities provided under the same agreement are split in case of a resolution may lead to unexpected losses for banks who in their daily risk management procedures will not be able to foresee exactly how a possible resolution related to an unknown counterparty may impact its counterparty risk.

We also find that it should be considered if the proposed safeguards should lead to amendments of or supplements to the Financial Collateral Directive. Financial Collateral Agreements including netting agreements are regulated by that directive while this is not the case for set off and structured finance arrangements.

We agree that the protection against cherry picking if a resolution is commenced may affect the flexibility of the resolution authority. However, we find that the safeguard of legally sound agreements on which market participants base their risk management should be protected.

We also find that express provisions for the protection of trading, clearing and settlement systems should be made. The provisions of the Settlement Finality Directive should suffice provided that the priority between the Settlement Finality Directive and the crisis management framework is clearly defined. If amendments or supplements to the Settlement Finality Directive are required or are desirable may depend on the final wording of the crisis management legislation.

Group Resolution (Part 5 – question box 52-53))
We agree that there is an urgent need to strengthen cross-border cooperation during emergency situations and to prevent fragmented national responses.

In order to ensure effective coordination and take advantage of existing structures we believe that the 'institutionalisation' of cross-border resolution groups as suggested by the Commission should be implemented through the existing cross-border stability groups. A possibility would be to form a resolution college as a subgroup to the cross-border stability groups. In this context the Nordic-Baltic Cross-Border Stability Group (NBSG) has been established in mid 2010 to implement the Nordic and Baltic agreement on financial stability.

A challenge in implementing effective resolution colleges will be to ensure that responsibilities for group resolution are not dissipated in a committee structure that will remain relatively complicated and fragmented. We welcome that the group level resolution authority can decide on the composition of the resolution college.

We find that resolution colleges can prepare the emergency situation and take into account the responsibilities of national authorities and strive for a voluntary joint decision as to the activation of an agreed group resolution plan. A common toolbox of resolution tools can facilitate group resolution.

We find that the framework strikes an appropriate balance between the coordination of necessary actions to deal with a group in an imminent crisis and the need for authorities to react quickly if the situation requires it.

Financing arrangements (Part 6 – question box 57-61)
We strongly support that member states should be able to meet financing requirements for the resolution regimes through the existing structure of the deposit guarantee schemes in order to exploit synergies. The compatibility of such an approach with staid aid rules should be made clear.

As for the target size and the phasing in of the fund it is necessary to take into account the various other regulatory initiatives under way, e.g. capital and liquidity requirements, as well as the revision of the directive on

deposit guarantee schemes. Too strict financing requirements in the new resolution regime may risk destabilising the financial systems in member states. An appropriate balance between ex ante and ex post financing is therefore necessary.

Design of debt write down as a resolution tool (Annex I – question box 62-66)

We fully support the introduction of a resolution tool as proposed by the Commission with a possibility to write off all equity and either write off subordinated debt or convert it into an equity claim. Such approach would be in line with the principles underlying the current Danish resolution framework.

To provide sufficient flexibility in the resolution phase the Commission considers two possible models for additional write down powers.

A comprehensive approach where the authorities are given a statutory power to write down by a discretionary amount or convert to an equity claim all senior debt. The comprehensive approach aims to make a broad range of senior creditors face the real risks associated with failure of credit institutions. It would be exercisable in principle in relation to all senior debt.

Furthermore, a targeted approach where the authorities require credit institutions to issue a fixed volume of 'bail-in able' debt which could be written down or converted into equity based on a statutory trigger.

A transparent and credible possibility of debt write down will be necessary to ensure that creditors of especially large credit institutions will do a thorough analysis of credit risk before lending to a credit institution. In addition it is also necessary to ensure resolution of a credit institution without government intervention. With a debt write down the credit institution can continue its business to the benefit of the economy.

The comprehensive approach is preferred since it is at least as attractive as the alternative (i.e. liquidation) to creditors. This is important because otherwise there will be creditors who would have been better off in a liquidation process and consequently could hold the management or the resolution authority responsible for their loss. Furthermore, this approach works in all circumstances since - contrary to the targeted approach - there is no upper limit to the write down.

It should be ensured that all creditors of the same ranking (in respect of the situation in liquidation) should receive the same write down. Shares, hybrids and subordinated debt should be written down first. All classes of other debt should be written down with the same percentage. Also depositors should be faced with write downs. The deposit guarantee scheme will, however, cover most of the losses.

It should be noted that if a debt write down applies to shares or existing debt issued before entry into force of the power such write down could be expropriatory and a compensation mechanism would be necessary.

The write down should be calculated based on the debt net of eventual loans etc. i.e. a depositor with deposits of EUR 1 million and a loan of EUR 1 million should be set-off and should not face any write down.

The condition for entering into a debt write down could be that the supervisor finds that a bank no longer possesses sufficient total capital instruments as required under the CRD. However, in practice it is also a necessary condition that the credit institution:
- has incurred losses that will deplete its equity, or
- is or is likely to be unable to pay its obligations in the normal course of business.

The write down must as a consequence be followed by a takeover and a recapitalization by the resolution authority for the institution again to fulfill the capital requirement.

The amount of write down will have to be determined or evaluated by authorized public accountants.

However, there are also merits in the targeted approach. The write down feature will only affect an investor group which already knows this risk and minimizes the risk of the holders of "truly" senior tranches. Based on the Danish experience the need for write down can, however, turn out to be significant. In a present case the write down was 40 percent. However, if around 30 per cent of the total liabilities are with a write down feature it would help to ensure that most institutions are resolvable. It is, however, not clear that it would be possible in practice to issue such large amounts.

A further advantage of the targeted approach is that it does not contain the same problems in relation to expropriation and rights of shareholders and creditors as the comprehensive approach since the write down is made on a contractual basis.

As we understand it, the targeted approach can be used in both going and gone concern. If used in a going concern, i.e. debt is converted to equity in order to avoid bankruptcy, debt holders will probably expect shareholders to bear losses as well. Furthermore, if the issuance of "bail-in able" debt is required by the authorities there is a question as to the market demand for such debt and what to do if the bank cannot sell the amount of "bail-in able" debt required by the authorities.

As mentioned earlier we find that there must be no doubt that holders of covered bonds and junior covered bonds always will receive timely payment. Holders of covered bonds shall according to CRD and UCITS benefit from a privileged status in case of bankruptcy and holders of junior covered bonds do also benefit from such a status. It should therefore be made clear that covered bonds and junior covered bonds should not be subject to debt write down.

Company Law (Annex II – question box 69-70)
Firstly it should be mentioned that the existing Danish resolution system coexists with and does not require derogations from national company law.

Evidence from the recent financial crisis seems to suggest that there could be a need for creating a mechanism for a rapid increase of capital.

Option 2 (a general meeting mandate to the management body) would provide the possibility for a more rapid increase of capital whereas Option 1 (shortened convocation period) would leave the shareholders more in control of the capital increase. We find that depending on the state of the emergency speediness or shareholder control could be the priority.

According to the working document Option 2 presupposes a derogation from the 2nd Company Law Directive. In that context it should be noted that Article 25(2) of that directive already provides for the possibility of a mandate which, however, must not be longer than maximum 5 years.

It is unclear what would be the situation in case the general meeting does not provide for either of the two options. Presumably the normal framework would apply with the risk that the capital increase can not be decided on in time to prevent the financial institution from entering the resolution phase.

Annex II: The Danish winding-up framework

In the autumn of 2010 Denmark established a national crisis resolution mechanism to deal with distressed banks. The objective of the Danish resolution mechanism is to safeguard financial stability and to minimize economic losses when a bank becomes unable to meet the statutory capital requirements. The framework offers the banks an alternative to ordinary liquidation if it is not possible to find a private solution. A distressed bank can decide on a voluntary basis to be wound up under the resolution mechanism.

The steps in the resolution mechanism are the following:

- When a bank no longer meets the statutory solvency requirement the Danish Financial Supervisory Authority sets a date at which the bank again has to comply with the solvency requirement. This is the trigger for the framework.

- Within six hours after the receipt of the injunction the bank has to notify the Danish Financial Supervisory Authority whether it wants to be resolved by the Danish Financial Stability Company A/S (in case it fails to meet the solvency requirements in time).

- Within the timeframe set by the Danish Financial Supervisory Authority the bank can make private arrangements to stabilize the bank or the bank can enter into a transfer agreement with the Danish Financial Stability Company A/S.

- According to statutory requirements banks shall at all times be able to within 24 hours to produce necessary statements and information about deposit and loan accounts, pension custody accounts etc. of the bank so that Danish Financial Stability Company A/S can make a preliminary valuation of the assets and liabilities.

- Procedures have been set in place between relevant national authorities making it possible for a transfer to be effected during a weekend (establishing a new bank, provide the new bank with sufficient capital, and, if necessary, liquidity, transfer the assets etc.).

The "old" bank goes bankrupt and is liquidated in accordance with ordinary bankruptcy law. The framework allows for potential losses to senior creditors and large depositors as well as shareholders and subordinated debt while maintaining a going concern organization. After the transfer the Financial Stability Company will reorganize the "new" bank and resolve it.

The new scheme was tested for the first time during the weekend of 4-6 February 2011 when Amagerbanken A/S - a Copenhagen based bank rep-

resenting around 1 per cent of the total amount of loans granted by Danish banks - notified on 4 February 2011 the Danish Financial Supervisory Authority that it no longer met the solvency requirement under the Danish Financial Business Act. The bank was given until 6 February 2011 (7 p.m.) to fulfil the solvency requirement set by the Danish Financial Supervisory Authority. During the weekend the bank entered into a transfer agreement with the Danish Financial Stability Company (Finansiel Stabilitet A/S) and effective of 6 February 2011 Amagerbanken A/S transferred all of its assets to a newly formed subsidiary bank under Finansiel Stabilitet A/S. Customers normal banking business (e.g. use of credit cards, debtor cards etc.) were not affected during the weekend. The bank opened as usual Monday morning with no apparent difference for the customers, who can still conduct normal banking business.

Payment for the transferred assets has been set at a preliminary DKK 15.2 billion, corresponding to approximately 59 per cent of the bank's unsecured senior liabilities. Payment has been effected by the new bank taking over liabilities in the same amount. Creditors including depositors whose net deposits with Amagerbanken A/S are in excess of EUR 100.000 (approx. DKK 750.000) must anticipate immediate losses of approximately 41 per cent as the bank is liquidated.

The final amount to be paid will be determined within three months from now by assessors appointed by the Institute of State Authorized Public Accountants in Denmark. If the final amount exceeds the preliminary amount the new bank will take over additional liabilities. There are currently known liabilities of DKK 13.2 billion which will not be taken over - of these DKK 2.6 billion are subordinate liabilities and DKK 5.6 billion are liabilities individually guaranteed by the State.

The new bank will receive capital and liquidity from Finansiel Stabilitet A/S so that it will fulfil the capital and liquidity requirements under the Financial Business Act. If the closing of the bank yields proceeds exceeding Finansiel Stabilitet A/S' contribution plus interest accrued at a market-based rate of return requirement, the proceeds will be applied to cover liabilities not transferred to the new bank in which case the losses of creditors will be reduced.

The Commission has been informed about the transfer of all Amagerbanken A/S' assets to the newly formed subsidiary bank under Finansiel Stabilitet A/S and the transfer will be notified to the Commission in the near future.