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Regulatory Approaches to Troubled Financial Institutions– Dodd-Frank, Living Wills and Non-US Approaches

Ashley Katz
London
+44 20 3130 3818

Jeffrey P. Taft
Washington, DC
+1 202 263 3293

Sara S.M. Or
Hong Kong
+852 2843 2268

Jörg Wulfken
Frankfurt
+49 69 79 41 2951

Alexandria Carr
London
+44 20 3130 3398

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Introduction and Overview

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- Overview of Today's Program
  - An overview of the US bank insolvency regime and Dodd-Frank's living will requirement
  - The EU draft framework on recovery and resolution of banks and investment firms
  - Possible consequences of the European Commission's proposal to grant the European Central Bank supervisory responsibility for all banks in the Eurozone
  - The UK response to investment bank failures
  - Reaction to the global financial crisis in Asia

Today's Speakers

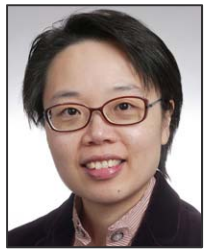
Cross-Border Restructuring INSTITUTE

Jeffry P. Taft
Partner, Washington DC
jtaft@mayerbrown.com

Dr. Jörg Wulfken
Partner, Frankfurt
jwulfken@mayerbrown.com

Alexandria Carr
Of Counsel, London
acarr@mayerbrown.com

Ashley Katz
Partner, London
akatz@mayerbrown.com



Sara S.M.Or
Partner, Hong Kong
Sara.or@mayerbrownjsm.com

US Bank Insolvency Regime

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- US Bankruptcy Code excludes insured depository institutions and the agencies and branches of foreign banks as eligible debtors under Chapters 7 and 11
- FDIC is generally the receiver or conservator for all insured depository institutions and the terms of the receivership or conservatorship is governed by the Federal Deposit Insurance Act

US Bank Insolvency Regime

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- Uninsured state-chartered branches and agencies of foreign banks are subject to the insolvency provisions in the state banking laws; the state banking commissioner is typically the receiver for state-chartered branches and agencies.
- Uninsured federal branches and agencies of foreign banks are subject to the insolvency provisions of the National Bank Act and the International Banking Act.

US Bank Insolvency Regime

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- Powers of the FDIC as Receiver or Conservator of an Insured Depository Institution
  - Automatic stay
  - Repudiation of contracts
  - Stay of legal proceedings
  - Avoid fraudulent conveyances
  - Avoid unwritten agreements
  - Treatment of QFCs

Dodd-Frank Act – Orderly Liquidation Authority

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- Orderly liquidation authority (OLA) designed to eliminate "too big to fail"
- Creates new resolution regime where FDIC appointed as receiver of "financial company" upon determination by US Treasury Secretary
- FDIC could be appointed as receiver for subsidiaries of financial company under certain circumstances
- US Bankruptcy Code remains primary resolution authority for financial companies

Dodd-Frank Act – Orderly Liquidation Authority

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- "Financial company" means –
  - organized or incorporated under federal or state law, and is either
  - a BHC; nonbank financial company supervised by the FRB; company that is "predominantly engaged" in financial activities; or any subsidiary of the foregoing that is predominantly engaged in financial activities.
- Powers of FDIC as receiver generally modeled after FDIA with certain changes to conform to US Bankruptcy Code
  - FDIC regulations clarifying claims process and statutory requirements
  - FDIC issued legal opinions to address preference and true sale issues
  - Creation of bridge financial companies

Dodd-Frank Act – Orderly Liquidation Authority

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- Cross-border Insolvencies
  - Difficult to have an orderly liquidation of a large interconnected multi-national financial services firm without some coordination amongst regulators and insolvency regimes.
  - OLA required a study on international coordination relating to the bankruptcy process for nonbank financial institutions.

Dodd-Frank Act – Living Wills

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- Dodd-Frank Act required bank holding company with consolidated assets of more than $50 billion to submit a Resolution Plan detailing how the company could be resolved quickly and effectively, avoiding serious disruptions to US financial stability
- Bank with more than $50 billion in total consolidated assets is required to file a separate plan covering resolution of bank with FDIC
- Likely file both plans simultaneously

Dodd-Frank Act – Living Wills

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- Resolution Plan Due Dates
  - **July 1, 2012** for covered companies with total nonbank assets of $250 billion or more (for non-US covered companies, $250 billion or more in total US nonbank assets)
  - **July 1, 2013** for Covered Companies with total nonbank assets between $100 billion and $250 billion (for non-US covered companies, between $100 billion and $250 billion in total US nonbank assets)
  - **December 31, 2013** for Covered Companies with total nonbank assets of less than $100 billion (for non-US covered companies, less than $100 billion in total US nonbank assets)

Dodd-Frank Act – Living Wills

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- Resolution Plan includes Seven Key Components
  - Executive summary
  - Strategic analysis
  - Corporate governance relating to resolution planning
  - Organizational structure
  - Management information systems
  - Interconnectedness and interdependencies
  - Supervisory information

The European Perspective: An Overview

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- EU draft framework for the recovery and resolution of credit institutions and investment firms
- June 6, 2012: European Commission presented a draft directive for the recovery and resolution of banks and investment firms (also referred to as Crisis Management Directive (CMD)
- Entry into force: 1 January 2015

  1 January 2018 bail-in provisions

The European Perspective: An Overview

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- Aims of the draft directive:
  - To avert systemic risks for the financial sector resulting from a bankruptcy of credit institutions and investment firms,
  - To resolve bank failures in an orderly way, inter alia, by improving cross-border cooperation,
  - To avert and prevent banking crises and spill-over effects and preserve financial stability,
  - Making shareholders and creditors pay for bank failures rather than using public funds.

The European Perspective: An Overview

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- Member States are required to appoint resolution authorities
- Coordination function for European Banking Authority (EBA)
- Preparation and prevention
  - Institutions are required to establish both recovery plans and resolution plans
    - Both on level of individual institution and group level
  - Intra-group financial support

The European Perspective: An Overview

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- Early intervention rights
  - *Intra-group* financial support
  - Appointment of special agent
- Resolution and liquidation
  - Sale of an institution or its business
  - Setting up a bridge institution
  - Spin-off of assets and liabilities
  - Bail-in

The European Perspective: An Overview

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- Resolution funding
  - Creation of settlement funds in Member States
  - Cross-funding of national settlement funds
  - Deposit Protection Schemes contribute by
    - Making payment to depositors
    - Funding resolution settlement funds

The European Perspective: An Overview

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- Implementation in Member States
  - Domestic law needs to be amended/supplemented
    - e.g. German Restructuring Act
  - Most Member States are required to pass new legislation
- Next Steps/Open issues
  - Institutions are required to prepare recovery and resolution plans
    - EBA Discussion Paper as guideline
    - In co-operation with national supervisory authorities
    - Role of European Central Bank to be determined

How Banking Union Proposals May Affect the Fiscal Responsibility for Banks in Europe

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- Proposal for a Council Regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions ie proposal for **banking union**
  - ECB will have prudential supervisory responsibility for all 6,000 or so banks in the Eurozone
  - But what about fiscal responsibility?

How Banking Union Proposals May Affect the Fiscal Responsibility for Banks in Europe

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- "When...[a single supervisory] mechanism will be in place for banks in the euro area the ESM could...have the possibility to recapitalize banks directly."
  - Euro area summit on **29 June 2012**
- Banking union proposals published on **12 September 2012** and intended to enter into force on **1 January 2013**
- But statement from Germany, Finland and Netherlands on **25 September 2012** seems to undermine possibility of ESM being used to recapitalize banks directly on 1 January

How Banking Union Proposals May Affect the Fiscal Responsibility for Banks in Europe

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- What's next?
  - Single European resolution authority?
  - Single deposit guarantee scheme?
  - Single resolution fund?
- Communication from the Commission, "The Roadmap Towards a Banking Union"
- cf. Articles 97 and 98 of the proposed Recovery and Resolution Directive
- cf. Proposal for a revision of the Deposit Guarantee Scheme directive

The UK Response to Investment Bank Failure

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- Overview
  - The Special Administration Regime (SAR) was the response to the perceived deficiencies in the UK insolvency regime
  - I will provide a brief overview of
    - How a standard administration operates
    - How special administration differs from the standard administration
    - Thoughts on the successes and failures of the new regime particularly in the context of the special administration of MF Global (MFG) in October 2011

Procedure Under the Standard Regime

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- Administration is intended to achieve one or more of the three sequential objectives:
  - rescuing the company as a going concern;
  - achieving a better result for the company's creditors as a whole than would be likely if the company were wound up (without first being in administration); or
  - realising property of the company in order to make a distribution to one or more secured or preferential creditors.
- Entry into administration takes place either by court order or through an out-of-court option

Special Administration Procedure

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- Unlike the standard procedure, a special administrator can only be appointed by court order on the application of, among others, the investment bank, the directors, one or more creditors, the Secretary of State or the Financial Services Authority (the FSA).
- An application will be granted only if the company is an investment bank and one of the following grounds can be shown:
  - The investment bank is or will be unable to pay its debts as they fall due;
  - it would be fair to put the investment bank into special administration; or
  - it is expedient in the public interest to put the investment bank into special administration (noting that only the Secretary of State may apply on this ground).

Special Administration Procedure (Con't.)

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- A key area of difference compared to the standard regime is that the SAR creates three special administration objectives which are not sequential but of equal value

  1. To ensure the return of client money or assets as soon as is reasonably practicable;
  2. To ensure timely engagement with market infrastructure bodies and the authorities; and
  3. Either: (a) to rescue the investment bank as a going concern; or (b) to wind it up in the best interest of creditors.

Special Administration Procedure (Con't.)

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- Within 8 weeks of appointment, the administrator must make a proposal to all creditors and clients, members, any present or former officers, the Registrar of Companies, as well as the FSA
- The proposal must be sent with the invitation to the initial creditors meeting
  - This is an important distinction compared to the standard regime, as clients are now able to approve the proposals as a separate class
- Investment Bank Special Administration Regulations 2011
  - Certain suppliers are unable to cease to provide the investment bank with services unless any amount owed for services provided post-appointment is not paid for more than 28 days after becoming due or the administrator or court consent to the termination
  - Enables the investment bank to continue to provide the services to its clients as long as the special administrator considers necessary
    - Which increases the level of protection for the clients

MF Global UK Limited – A Case Study

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- 31 October 2011 – The FSA confirms that MFG has entered the SAR
- 23 November 2011 – Special administrators set out some of the reasons for the delay in getting information out to clients, which include
  - Operation of the FSA client money rules
  - Special administration regime rules on segregated client assets
- 1 August 2012 – Trustee James Giddens announces US customers have received $4.7 billion, while in the UK only $159.5 million in client money distributions have been paid out, with the majority of client money claimants still left without even having their claims agreed

MF Global UK Limited – A Case Study

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- Why is the UK process more time-consuming?
  - Difficulties in identifying client money/client assets
    1. Client money becomes subject to a trust upon receipt and not upon the segregation of client money
    2. On a firm's insolvency all client money identifiable, in whatever account of the firm into which client money has been received, is pooled for distribution
    3. The client money pool is to be distributed to all clients in accordance with each client's respective contractual entitlement to have had client money segregated for it at the date of pooling and irrespective of whether any money had in fact been so segregated or had been recorded by the firm as having been so segregated.
  - Personal liability of special administrators

Hong Kong Perspective: Regulators Reaction to the Global Financial Crisis since 2008

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- The Financial Secretary established a Contingent Bank Capital Facility in October 2008 to make additional capital available to HK-incorporated banks
  - HKMA (banking regulator) pointed out in a press release in December 2011 that there has been no utilisation of the Facility by banks

Hong Kong Perspective: Regulators Reaction to the Global Financial Crisis since 2008

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- The Government guarantee under the deposit protection scheme was extended in October 2008 for a period of two years to guarantee all customer deposits with banks and deposit-taking companies in HK of which the guarantee expired on 31 December 2010
- Enhanced protection was introduced to the deposit protection scheme with effect from 1 January 2011, the main enhancements include
  - Raising the protection limit from HK$100,000 to HK$500,000
  - Extending protection to deposits held by banks as security or collateral

Hong Kong Perspective: Regulators Reaction to the Global Financial Crisis since 2008

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- HKMA implemented five temporary measures in October 2008 for providing liquidity assistance to banks (whether incorporated in HK or overseas). The five measures were implemented for a period of six months and expired on 31 March 2009 (except HKMA continued to maintain the fourth measure post-March 2009)
    - The eligible securities, for access by individual banks to liquidity assistance through the Discount Window, were expanded to include US$ assets of credit quality acceptable to HKMA
    - The duration of liquidity assistance provided to individual banks through the Discount Window would be extended, at the request of individual banks and on a case-by-case basis, from overnight money only to maturities of up to three months
    - The 50% threshold for the use of Exchange Fund paper as collateral for borrowing through the Discount Window at HKMA Base Rate would be raised to 100%, in effect waiving the 5% premium (or penalty) over the Base Rate for the use beyond the 50% threshold
    - HKMA would, in response to requests from individual banks and when it considered necessary, conduct foreign exchange swaps (between US$ and HK$) of various durations with banks
    - HKMA would, in response to requests from individual banks and when it considered necessary, lend term money of up to one month to individual banks against collateral of credit quality acceptable to HKMA

Hong Kong Perspective: Regulators Reaction to the Global Financial Crisis since 2008

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- HKMA and SFC (regulator of securities market) issued circulars to remind financial institutions of the importance of prudential financial management stressing risk management
- Other steps taken by the HK regulators but not directly targeting failing financial institutions include
  - Enhanced regulation of the sale of investment products to retail investors
  - Established the financial dispute resolution centre to facilitate resolution of dispute between financial institutions and retail investors
  - Introduced new licensing regime for credit rating agencies

MAYER·BROWN

Thank You.

Ashley Katz
London
+44 20 3130 3818

Jeffrey P. Taft
Washington, DC
+1 202 263 3293

Sara S.M. Or
Hong Kong
+852 2843 2268

Jörg Wulfken
Frankfurt
+49 69 79 41 2951

Alexandria Carr
London
+44 20 3130 3398

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Presenter Profiles

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Cross-Border Restructuring INSTITUTE

Ashley Katz
Partner – London
+44 20 3130 3818

Ashley Katz

Ashley Katz is joint head of Mayer Brown's Restructuring, Bankruptcy and Insolvency group in London. He has extensive experience advising financial institutions, borrowers, bondholders, insolvency practitioners and distressed investors in relation to all aspects of restructuring and insolvency matters.

Ashley advises on a range of cross-border and UK restructurings and insolvencies including matters in the automotive, real estate, construction, financial services, retail and leisure sectors.

Ashley has lectured on a range of insolvency topics including administration, anti-avoidance provisions, employment/insolvency law, directors' duties and customer insolvency.

Admitted

England and Wales 2001
South Africa 1996

Presenter Profiles

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INSTITUTE

Jeffrey Taft
Partner – Washington DC
+1 202 263 3293

Jeffrey Taft

Jeffrey Taft is a regulatory attorney whose practice focuses primarily on banking regulations, bank receivership and insolvency issues, payment systems, consumer financial services, privacy issues and anti-money laundering laws. He has extensive experience counseling financial institutions, merchants and other entities on various federal and state consumer credit issues, including compliance with the Consumer Financial Protection Act, Truth-in-Lending Act, the Fair Credit Reporting Act, the Electronic Fund Transfer Act, the Equal Credit Opportunity Act, the Fair Debt Collection Practices Act, the Real Estate Settlement Procedures Act, state and federal unfair or deceptive practices statutes, the Bank Secrecy Act, the USA PATRIOT Act, OFAC regulations and other anti-money laundering laws; and the creation and implementation of privacy and information security programs under Title V of the Gramm-Leach Bliley Act and state privacy laws.

Jeff regularly represents banks, bank holding companies, trust companies and other financial service providers on regulatory matters, including the development and operation of multi-state fiduciary, deposit and credit card programs. He has also advised merchants and financial services companies on issues relating to credit cards, debit cards, gift cards, wire and ACH transfers and other payment products.

Admitted

District of Columbia 2001
Ohio 1994
New York 1993

Presenter Profiles

Cross-Border Restructuring INSTITUTE

Sara S.M. Or
Partner – Hong Kong
+852 2843 2268

Sara S.M. Or

Sara Or is a partner of Mayer Brown JSM. She advises on securities, banking, commodities and insurance regulations, compliance, licensing and other regulatory matters including the use of electronic means for delivery of financial services. She has long-established, close working relationships with regulatory authorities such as the Hong Kong Monetary Authority, the Securities and Futures Commission and the Insurance Authority, and can advise on likely approaches to be adopted by the regulators.

Sara prepares standard client and product documents for banks, brokers and other financial institutions, and loan and security documentation. She also advises on personal data privacy matters.

Admitted

Hong Kong 1990

Presenter Profiles

Cross-Border Restructuring INSTITUTE

Dr. Jörg Wulfken
Partner – Frankfurt
+49 69 79 41 2951

Dr. Jörg Wulfken

Dr. Jörg Wulfken is a partner in the Frankfurt office of Mayer Brown's Finance practice. Jörg serves on Mayer Brown's global Management Committee, as well as on the firm's Asian Board, and he is the Managing Partner in Germany. Jörg has extensive experience in representing arrangers, originators, issuers, lenders, funds, servicers, borrowers and the German Government, in finance transactions, financial institutions, M&A, securitization and capital market transactions and bank lendings. In addition, Jörg particularly focuses on the areas of non-performing loan transactions, advising sellers, investors and financiers. As such, he has been involved in almost all major transactions of this kind including Lone Star's EUR 3.6 billion NPL purchase from Hypo Real Estate and Eurohypo's NPL joint venture with Citigroup. Also, he advised Lone Star on the acquisition of IKB Deutsche Industriebank AG. Recently, he advised the Financial Market Stabilization Fund (Sonderfonds Finanzmarktstabilisierung, SoFFin) on the establishment of the first "Bad Bank" in Germany.

In addition, Jörg has significant experience with the representation of clients in Austria. He represented the State of Lower Austria on the securitization of a EUR 2.6 billion housing loan portfolio, one of the first securitization transactions in Austria. He advised on one of the first sales of a non-performing loan portfolio in Austria and on derivative transactions with Austrian clients in connection with securitization.

Admitted

Frankfurt am Main, Germany 2000
Düsseldorf, Germany 1990

Presenter Profiles

Cross-Border Restructuring INSTITUTE

Alexandria Carr
Of Counsel – London
+44 20 3130 3398

Alexandria Carr

Alexandria Carr is a qualified barrister practising in London as Of Counsel with the Financial Services, Regulatory & Enforcement group. She has worked for the UK government for 13 years, the last 5 of which she has spent at the UK's ministry of finance, HM Treasury, working closely with people across government, the FSA, the Bank of England, ministries of finance across Europe and the institutions of the EU.

Alexandria has acted as the lead legal adviser on EU financial services strategy with a specific focus on the new EU financial services supervisory architecture. She has been the lawyer on the UK team that negotiated the European System of Financial Supervision (ESFS) (that established the new European Supervisory Authorities) and implemented the ESFS in the UK. Since the establishment of the ESFS in January 2011, she has advised HM Treasury on the changes it has made to the regulation and supervision of financial services. She has recently returned to Mayer Brown from a secondment to HM Treasury where she was legal advisor to a project team considering recent and projected developments in the Eurozone, including proposals for a EU banking union.

She has also advised HM Treasury on the EU's response to the financial crisis more generally as the EU seeks to reduce the discretion of individual Member States to legislate domestically and to develop a single EU rulebook for financial services. In addition, Alexandria was the lawyer on the UK teams negotiating Solvency II, the short selling regulation and the proposed market abuse regulation currently being negotiated. She advised HM Treasury on the new system for making subordinate EU financial services legislation (what is known as "level 2") post the Lisbon Treaty. Alexandria also has experience of regulation on a purely domestic level, having, for example, drafted the legislation which regulated Islamic finance and created a protected cell regime for Open Ended Investment Companies

Called to the Bar
England and Wales 1997