AUSTRIAN ACT ON THE RECOVERY AND RESOLUTION OF BANKS HAS ENTERED INTO FORCE

1. OVERVIEW

On 1 January 2015, the Austrian Act on the Recovery and Resolution of Banks (*Bundesgesetz über die Sanierung und Abwicklung von Banken – BaSAG*)[1] implementing the Bank Recovery and Resolution Directive (BRRD)[2] entered into force. Earlier than foreseen by the BRRD, the bail-in tool will apply in Austria from 1 January 2015 on.

Some parts of the BRRD (i.e. the provisions regarding prevention and early intervention) have been transposed in Austria already in advance by the Austrian Banking Intervention and Restructuring Act (*Bankeninterventions- und -restrukturierungsgesetz – BIRG*) which entered into force on 1 January 2014 and now is repealed by the BaSAG.

The BRRD aims to provide the resolution authorities, in Austria the Austrian Financial Market Authority (*Finanzmarktaufsichtsbehörde – FMA*), with common tools and powers to address banking crises pre-emptively in order to ensure financial stability and to minimize taxpayers' exposure to losses. These measures shall prevent scenarios in which distressed banks are considered "too big to fail" and thus, have to be bailed out by the taxpayers.

Hence, the BRRD (and also the BaSAG) follows two main objectives:

- to prevent insolvency of financial institutions and, in case insolvency cannot be prevented, to minimize its negative effects; and
- to avoid taxpayer bail-outs by shifting the costs of insolvency of an institution from the public to the respective stakeholders (i.e., shareholders and creditors).

[1] See Austrian Federal Law Gazette (*Bundesgesetzblatt*) BGBl I 2014/98 published on 29 December 2014.

[2] Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council.

2. PREVENTION

The BRRD (and the BaSAG) *inter alia* requires institutions to draw up "recovery and resolution plans" which set out certain arrangements and measures that may be taken to restore the long-term viability of a financial institution in the event of a material deterioration of its financial position. The central aim of these plans is to ensure the continuation of the institution's critical functions in such situations.

If the resolution authority identifies any obstacle to the institution's resolvability, a change of corporate or legal structure can be mandated so that it can be resolved without threatening financial stability or entailing costs for the taxpayer.

3. EARLY INTERVENTION

In the event of a severe crisis of an institution, the FMA has certain intervention powers in order to avoid a public bailout, such as:

- instruction to implement steps laid down in the recovery plan;
- convocation (and determination of the agenda) of shareholders' meetings;
- dismissal of members of the management and/or supervisory board and appointment of a temporary administrator; and
- demanding changes in the management strategy of the institution.

4. RESOLUTION

In case the early intervention measures were not successful in preventing the institution's collapse and an 'ordinary' insolvency proceeding[3] is not in the public interest due to its potential to threaten financial stability, a controlled resolution will be conducted according to the BaSAG. For this purpose, the FMA in its function as resolution authority is conferred important powers to apply the following resolution tools:

- sale of business tool: to undertake a private-sector acquisition of all or some parts of the institution without the consent of its shareholders;
- bridge institution tool: to create a bridge bank, i.e. a temporary structure to which the business is transferred in order to preserve the institution's essential functions;

[3] Following the provisions of the Austrian Insolvency Act (*Insolvenzordnung – IO*).

- asset separation tool: to separate the institution's assets into a good bank and a bad bank by partially transferring its assets; and

- bail-in tool: to arrange a bail-in of creditors, hence a reduction of the institution's liabilities by a forced conversion of its debt into equity or by a full or partial write-down of its debt.

According to the BRRD (and the BaSAG), Additional Tier 1 and Tier 2 capital instruments shall fully absorb losses at the point of non-viability of the issuing institution. Accordingly, resolution authorities are required to write down capital instruments in full, or to convert them to Common Equity Tier 1 instruments at the point of non-viability and before any resolution action is taken (statutory loss absorption). For that purpose, the point of non-viability should be understood as the point at which the relevant authority determines that the institution meets the conditions for resolution or the point at which the resolution authority decides that the institution would cease to be viable if those capital instruments were not written down or converted. A write-down or conversion would follow the ordinary allocation of losses and ranking in an insolvency of the relevant institution. However, as a safeguard, no creditor shall by use of these tools be in a worse position than in ordinary insolvency proceedings ("no creditor worse-off" principle).

Any write-down or conversion of all or parts of the principal amount of capital instruments, including accrued but unpaid interest in respect thereof, would not constitute an event of default under the terms of the relevant instruments.

The resolution authority may also amend or alter the maturity of certain instruments or the amount of interest payable under such instruments, or the date on which interest becomes payable, including by suspending payment for a temporary period.

The resolution authority shall use the above-mentioned tools to ensure the continuity of critical functions of the institution under resolution; to avoid a significant adverse effect on the financial system; as well as to protect public funds, depositors covered by depositor guarantee schemes; and client funds and client assets.

When exercising such powers, the resolution authority must choose those measures that best achieve the applicable objectives, seek to minimize the costs of the resolution and avoid any possible unnecessary destruction of value. Furthermore, any resolution action shall be taken in accordance with the following principles:

- shareholders of the institution under resolution bear first losses;
- creditors generally bear losses after the shareholders;
- the management body and senior management of the institution are replaced and provide all necessary assistance for the achievement of the resolution objectives;
- natural and legal persons are made liable under civil or criminal law for their responsibility;
- creditors of the same class are treated in an equitable manner;
- no creditor shall incur greater losses than it would have been incurred if the institution had been wound up under normal insolvency proceedings (see above);
- covered deposits (up to EUR 100,000) are fully protected; and
- resolution tools are applied in accordance with the safeguards set out in the BaSAG.

A further important feature of the resolution process is the mandatory valuation of the institution's assets and liabilities. Its liquidation value hereby serves as a point of reference. The resolution authority shall ensure that a fair, prudent and realistic valuation of the institution's assets and liabilities is carried out by an independent person. The valuation result will then serve as basis for the decision as to whether resolution measures are needed.

5. SCOPE OF APPLICATION

In line with the BRRD, the BaSAG applies to institutions (i.e. credit institutions and large investment firms subject to the Capital Requirements Regulation (CRR)[4]) as well as to financial holding companies, mixed financial holding companies and subsidiary financial institutions of EU credit institutions or investment firms.

However, in addition (and going beyond the requirements of the BRRD), the BaSAG may also apply to Austrian "bad banks": Certain institutions with the sole purpose of administrating their assets and liabilities for ensuring an orderly and active realization of the assets on the best possible terms (portfolio reduction) may apply for being continued as a wind-down unit (*Abbaugesellschaft*) provided that such institution

[4] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.

- does not enter into new business activities with third parties (unless necessary for the purpose of realization of assets);
- does no longer accept any deposits from the public;
- has established procedures to ensure the ongoing information and support of remaining business partners; and
- has already before 31 December 2014 conducted its business activities according to a resolution or restructuring plan approved by the EU Commission.

On such wind-down unit, the provisions governing the asset separation tool under the BaSAG apply accordingly. Upon completion of the portfolio reduction the institution has to be dissolved.

Moreover, the BaSAG resolution regime *ex lege* applies to the state-owned wind-down unit HETA ASSET RESOLUTION AG (formerly: HYPO-ALPE-ADRIA-BANK INTERNATIONAL AG).

6. RIGHTS OF SHAREHOLDERS AND CREDITORS

Possibilities to challenge the application of the above-mentioned resolution proceedings are very limited: The BaSAG explicitly excludes certain remedies against legal acts detrimental to creditors that are admissible under ordinary Austrian insolvency law against actions taken according to the new resolution regime. Furthermore, with respect to an institution under resolution or an institution in relation to which the conditions for resolution have been determined to be met, normal insolvency proceedings shall not be commenced except at the initiative of the resolution authority.

In addition to that, typical contractually negotiated safeguards against losses that result from the insolvency of the debtor will mostly be ineffective. The resolution authority is endowed with the power to exclude or suspend the effectiveness of certain contractual terms in relation to an institution under resolution. This applies to *inter alia* default provisions, security rights and termination rights.

Nonetheless, some specific contractual agreements are protected under the BaSAG:

- financial collateral, set-off and netting arrangements;
- security arrangements;
- structured finance arrangements and covered bonds; and
- trading, clearing and settlement systems.

Moreover, a person affected by an action taken according to the new resolution regime has the right to appeal against that decision. Yet, the launch of an appeal generally does not entail any automatic suspension of the effects of the challenged decision, which will be immediately enforceable. Therefore, in most cases remedies for a wrongful decision or action by the resolution authority will be limited to compensation for the loss suffered by the applicant as a result of the decision or act.

7. FINANCING THE NEW RESOLUTION REGIME

To ensure the main purpose of the new legal regime, namely that the resolution costs of ailing financial institutions do not fall upon the taxpayer, new financing arrangements are set up: These facilities are financed by regular contributions of banks and investment firms in proportion to their size, risk profile and liabilities. By the end of 2024 an overall funding level of at least 1% of the amount of covered deposits of all institutions shall be achieved.

These financing arrangements may be used by the resolution authority only to the extent necessary to ensure the effective application of the resolution powers, especially for the following purposes:

- to guarantee the assets or the liabilities of the institution under resolution or its subsidiaries;
- to make loans to the institution or its subsidiaries,
- to purchase assets of the institution;
- to make contributions to a bridge institution and an asset management vehicle; or
- to pay compensation to impaired shareholders or creditors.

Contacts

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