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The Regulatory Framework of Forced Restructuring of Banks in the Polish Legal System

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Abstract: *The presented paper deals with the issues concerning the means of forced restructuring of banks in the Polish legal system. The term "means of forced restructuring of banks" should be understood as a set of legal rules that allows to reorganise a bank under the threat of a bankruptcy. Forced restructuring is also referred as a special resolution regime. Means of forced restructuring constitute, in fact, an administrative method of affecting banks the functioning of which jeopardises the stability of financial system. The thesis of this paper constitutes the statement that means of forced restructuring create a coherent, complementary system of legal means that allows to reorganise national, i.e. domestic bank without spending public funds. Thanks to the means of forced restructuring, the responsibility for the bank losses, including the costs of its forced restructuring, remains with the shareholders or members of the bank as well as with its creditors, not with the state budget. Variability of using the means of forced restructuring allows to adjust the reorganisation process of the bank to the circumstances that relate to the bank itself and to the level of recession on the financial markets.*

Key Words: *Financial Law; Banking Law; Resolution; Forced Restructuring; Bail-in; Banks; Poland.*

Introductory remarks

The presented paper deals with the issues concerning the means of forced restructuring of banks in the Polish legal system. The term "means of forced restructuring of banks" should be understood as a set of legal rules that allows to reorganise a bank under the threat of a bankruptcy. Forced restructuring is also referred as a special resolution regime.[2]

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[2] About special resolution regime see BRIERLEY, P. *The UK Special Resolution Regime for Failing Banks in an International Context*. London: Bank of England, 2009. 15 p. Financial

Means of forced restructuring constitute, in fact, an administrative method of affecting banks the functioning of which jeopardises the stability of financial system. However, the subject which has been granted the competence of using the means of forced restructuring towards banks is in Poland the Bank Guarantee Fund.

The basic thesis of our paper constitutes the statement that means of forced restructuring create a coherent, complementary system of legal means that allows to reorganise national, i.e. domestic bank without spending public funds. Thanks to the means of forced restructuring, the responsibility for the bank losses, including the costs of its forced restructuring, remains with the shareholders or members of the bank as well as with its creditors, not with the state budget. Variability of using the means of forced restructuring allows to adjust the reorganisation process of the bank to the circumstances that relate to the bank itself and to the level of recession on the financial markets. The main purpose of the paper is to describe normative construction of the means of forced restructuring of a bank and legal issues related to the topic. In order to achieve the main purpose, specific objectives had to be pursued. The main purpose of the paper encourages researches on the essence and nature of the regime of forced restructuring of banks in the Polish legal system. Factors of a normative nature that shape the decision-making of the Bank Guarantee Fund were examined. The assessment of those factors

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and the resulting effects have an influence on the decision-making associated with the specific means of forced restructuring of a bank.

The topic of the study presented in our paper falls within a broader issue of security of the financial markets. Means of forced restructuring constitute an element of providing the stability of the financial system. Their application aims to minimise negative effects connected with the threat of a bankruptcy of a national bank. The issue discussed in this paper concerns public and legal regulation of the actions of national banks, i.e. the banks domiciled in the territory of the Republic of Poland. Covering only the activities of national banks which operate in a form of a joint-stock company or a cooperative society is justified by the subjects' key influence on the financial system. The comments concerning the means of forced restructuring of banks can easily be transferred to other subjects for those the regimen of forced restructuring can be applied.

The essence of forced restructuring of banks

Forced restructuring of banks constitutes an extrajudicial mode that allows to conduct changes in organisational and capital structures of a bank in a crisis situation in a fast and procedurally simplified manner. Means of forced restructuring can only be applied in an emergency situation. The Bank Guarantee Fund is obliged to use the means when the bank is under the threat of a bankruptcy and there is no indication that the possible supervisory actions or the bank's actions will make it possible to remove the risk of bankruptcy. Means of forced restructuring constitute a method of protecting the common good which are the stability of the financial system and the security of the public finance. The Bank Guarantee Fund, on the other hand, protects the public interest using the means of forced restructuring of banks.

Experiences drawn from the last global financial crisis have forced the creation of legislative changes which enable to solve critical situations on the financial markets in an effective and coordinated manner.[3] Past legal regulations did not allow for preparation, prevention and effective restructuring of banks under the threat of a bankruptcy as well as of

[3] Further see LASTRA, R. M. *Legal and Regulatory Responses to the Financial Crisis*. London: Queen Mary University of London, School of Law, 2012, p. 1. Legal Studies Research Paper, no. 100/2012; and FERRAN, E. *Crisis-driven EU Financial Regulatory Reform*. Cambridge: University of Cambridge, Faculty of Law, 2012. 35 p. Legal Studies Research Paper, no. 6/2012.

other financial institutions. The only way to save such banks was to provide them with a financial help from public resources. Excessive public spending was aimed to prevent the system crisis which occurred due to the transfer of the crisis on to other financial institutions. As a result, costs of the financial crisis for industrial countries of the G20 group amounted to about 2.7 % of the gross domestic product (hereinafter referred to as the "GDP"). The total amount of support which had been committed to, including warranties and other contingent liabilities, reached circa 25 % of the GDP.[4] The amount of an approved public help for the financial institutions under the threat of a bankruptcy reached in the Member States of the European Union more than 5 billion EUR between years 2008 and 2012.[5] It means that the amount of public help approved by the European Commission equals 40.3 % of the GDP of the whole European Union. However, the total value of funds actually used as a part of public help for the financial institutions amounted to 1.6 billion EUR, which constitutes 12.8 % of the GDP of the European Union.[6]

As a result, in year 2010 measures designed to create legal solutions that were to minimise any disruptions caused by the bankruptcy of financial institutions were taken at the European Union level.[7] The outcome of this effort was the drawing-up of two European Union directives. The first one is the Directive of the European Parliament and Council 2014/59/EU from the 15th of May 2014 which establishes frameworks for taking corrective actions, restructuring and resolution regarding the credit institutions and investment companies.[8] The second one is the Di-

[4] See *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the European Central Bank: Bank Resolution Funds* [2010-05-26]. COM (2010) 254 final, p. 2.

[5] In detail see *European Commission, Commission Staff Working Paper – Autumn 2012 Update* [2012-12-21]. COM (2012) 778 final, p. 29.

[6] See *European Commission, Commission Staff Working Paper – Autumn 2012 Update* [2012-12-21]. COM (2012) 778 final, p. 29.

[7] Further see *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee, the Committee of the Regions and the European Central Bank: An EU Framework for Crisis Management in the Financial Sector* [2010-10-20]. COM (2010) 579 final.

[8] See *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, text with EEA relevance*. OJ EU L 173, 2014-06-12, pp. 190-348.

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rective of the European Parliament and Council 2014/49/EU from the 16th of April 2014 concerning the deposit-guarantee schemes.[9]

The above-mentioned directives were implemented into the Polish legal system under the provisions of the Act from the 10th of June 2016 on the Bank Guarantee Fund, Deposit Guarantee Scheme and Forced Restructuring (hereinafter referred to as the "Act"). This Act entered into force on the 10th of October 2016. The rules contained in the mentioned Act provide a legal framework for forced restructuring of banks. National public authorities were given legal rights to effectively minimise negative effects of the national banks' crisis. In the Polish legal system, there were no administrative and legal means which would allow for quick restructuring of banks under the threat of a bankruptcy that had an important meaning for the national financial system and maintaining their critical functions. The above-mentioned Act seems to fill the legal loophole in this regard. There has never been excessive spending of public funds to save the stability of the financial system so far. According to the Article 66 of the Act from the 10th of June 2016 on the Bank Guarantee Fund, Deposit Guarantee Scheme and Forced Restructuring, the resolution shall seek to meet the following objectives:

1) to maintain the financial stability, in particular through the protection of confidence in the financial sector, and to ensure the market discipline;
2) to limit the involvement of public funds or the likelihood of their exposure to the financial sector or its individual entities to achieve the objectives referred to in point 1 and points 3 – 5;
3) to ensure the ongoing performance of the critical functions carried out by an entity;
4) to protect depositors and investors covered by the compensation system; and
5) to protect funds entrusted to the company by its customers.

The Bank Guarantee Fund shall pursue the objectives referred to in the above-stated Article 66 by three ways. Firstly, the Bank Guarantee Fund develops plans for the forced restructuring, including the determination of the minimum level of the own funds and liabilities subject to write-down or conversion. Secondly, the Bank Guarantee Fund is author-

[9] See *Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on Deposit Guarantee Schemes, text with EEA relevance*. OJ EU L 173, 2014-06-12, pp. 149-178.

ised to realise write-down or conversion of capital instruments. Thirdly, the Bank Guarantee Fund is obliged to carry out the forced restructuring of banks. While pursuing the aims of the resolution, the Bank Guarantee Fund shall seek to reduce the costs of the forced restructuring. Pursuant to the Article 67 paragraph 2 of the mentioned Act, if possible, by considering the objectives of forced restructuring, the Bank Guarantee Fund should reduce the loss of the undertaking value of an entity towards which the forced restructuring is carried out.

Main phases of forced restructuring of banks

Forced restructuring of banks constitutes a carefully planned as well as legally and economically justified process. It is divided into three main phases. The first phase is to plan and to prepare forced restructuring of banks. Launching the process of forced restructuring and its application under certain measures is not possible without the phase of planning and preparation. This phase will have a strong bearing on the process of forced restructuring of banks.

With a view to arranging for the forced restructuring resolution, the Bank Guarantee Fund, following the consultation with the Polish Financial Supervision Authority, shall develop a plan for the resolution for a domestic entity that is not a part of a group subject to a consolidated supervision in a Member State of the European Union by the supervisory authorities other than the Polish Financial Supervision Authority. The plan of forced restructuring shall envisage measures towards an entity in the case of initiation of resolution and feasibility evaluation of these activities. In particular the plan of forced restructuring indicates a detailed description of the possible restructuring options, including the possibility of using individual instruments of resolution, manner of separation of critical functions and main lines of business of an entity as well as description of the principles of financing of possible variants of resolution.[10]

[10] In particular about the resolution planning see AVGOULEAS, E., Ch. GOODHART and D. SCHOENMAKER. Bank Resolution Plans as a Catalyst for Global Financial Reform. *Journal of Financial Stability*. 2012, vol. 9, no. 2, pp. 210-218. ISSN 1572-3089; SCHILLIG, M. Bank Resolution Regimes in Europe – Part I: Recovery and Resolution Planning, Early Intervention. *European Business Law Review*. 2013, vol. 24, no. 6, pp. 751-779. ISSN 0959-6941; and GUYNN, R. D. Resolution Planning in the United States. In: A. DOMBRET and P. S. KENADJIAN, eds. *The Bank Recovery and Resolution Directive: Europe's Solution for "Too Big to Fail"?*. 1st ed. Berlin; Boston: De Gruyter, 2013, p. 109. ISBN 978-3-11-032107-4.

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On the grounds of the Article 89 paragraph 1 of the above-stated Act from the 10th of June 2016, the Bank Guarantee Fund shall, at least once a year, review and assess the feasibility of the forced restructuring. The Bank Guarantee Fund should make the first assessment of the feasibility of plans at the stage of their development. Following a significant organisational or legal change in an entity, in particular the acquisition or disposal of subsidiaries, change of the organisational structure of the entity, change of the parent company, change of domicile of the parent company and change in business or the financial situation of the entity or upon the occurrence of another event, the Bank Guarantee Fund shall assess the feasibility of the plan and, if necessary, following the consultation with the Polish Financial Supervision Authority, shall update the plan.

The second phase is to launch and to conduct forced restructuring towards banks. As a result, the pressure should be put on the grounds for initiation of forced restructuring of banks and on the criteria on which the measures of forced restructuring were selected. It is the central issue to understand the essence of forced restructuring. Although the Bank Guarantee Fund conducts forced restructuring, its initiation is not possible without the participation of the Polish Financial Supervision Authority. The financial regulatory authority shall forthwith notify the Bank Guarantee Fund of the following threat of a bankruptcy of a bank and also of a lack of indication that the feasible supervisory measures or the measures of this entity will allow a timely removal of this threat. Importantly, the Polish Financial Supervision Authority considers a bank to be at risk of a bankruptcy if one or more of the four circumstances appear. On the grounds of the Article 101 paragraph 3 of the above-mentioned Act, a bank shall be considered at risk of a bankruptcy if at least one of the following circumstances occurs:

1) indications occur that will fail to satisfy the operating business conditions to the extent justifying the repeal or revocation of a license to establish a bank;
2) assets of a bank are not sufficient to cover its liabilities or indications occur that cause the assets of an entity to be not sufficient to cover its liabilities;
3) a bank fails to settle its due liabilities or indications occur that will fail to do so; or
4) continuation of business of an entity requires involvement of extraordinary public funds.

Subsequently, the Bank Guarantee Fund, after obtaining information about a threat of a bankruptcy of a bank and lack of indication that the feasible supervisory measures or the measures of this entity will allow a timely removal of this threat, is obliged to assess the reasons for issuing a decision regarding the initiation of forced restructuring. These conditions are set out in the Article 101 paragraph 7 of the above-stated Act from the 10th of June 2016. If a bank is at risk of a bankruptcy, no indications occur that the feasible supervisory measures or the measures of the bank will allow in due time to remove the threat of a bankruptcy and measures towards this entity are required in view of the public interest, the Bank Guarantee Fund issues a decision on the initiation of forced restructuring towards a domestic entity or a decision on write-down or conversion of capital instruments. The measures shall be taken in the public interest if they are necessary to ensure implementation of at least one of the objectives of forced restructuring laid down in the Article 66 of the mentioned Act and these objectives may not be attained to the same extent under the supervision or bankruptcy proceedings.

Finally, the last of the three phases of forced restructuring is the completion of forced restructuring of a bank. The completion of forced restructuring of a bank results in an uprising number of legal obligations towards the Bank Guarantee Fund. Legally defined consequences which occur after the initiation of forced restructuring towards a bank, its shareholders or members as well as its creditors have a great impact on the efficiency and effectiveness of the process of forced restructuring. The legislator has granted the shareholders and creditors the right to satisfy their receivables in the case of a forced restructuring of a bank at the level no lower than they would incur in normal insolvency proceedings. Pursuant to the Article 241 paragraph 1 of the above-stated Act from the 10th of June 2016, in order to determine whether shareholders or members and creditors were satisfied as a result of forced restructuring to a degree lower than they would have been satisfied in the bankruptcy proceedings in a case that on the day of the decision to initiate resolution the court had issued a ruling on declaration of the debtor's bankruptcy, the Bank Guarantee Fund shall commission an additional valuation. The shareholders or members and creditors who have been satisfied as a result of resolution to a degree lower than they would have been satisfied in the procedure referred to in the Article 241 paragraph 1 of the above-mentioned Act shall be entitled to a supplementary claim vis-à-vis the Bank Guarantee Fund.

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Means of forced restructuring of banks

The legislator provides in the Article 110 paragraph 1 of the mentioned Act from the 10th of June 2016 a catalogue of measures of forced restructuring of banks.[11] In the first place, it is the measure of acquisition of a bank through restructuring, in the second place, it is the measure of a bridge institution, in the third place, it is the measure of cancellation or conversion of liabilities, and in the last place, it is the measure of separation of the property rights.

The measure of acquisition of a bank through forced restructuring constitutes a special example of economic concentration. It is an economic concentration of compulsory nature. Acquisition of a bank is carried out on the initiative of the authority of forced restructuring, the Bank Guarantee Fund. Pursuant to the Article 178 paragraph 1 of the mentioned Act, the Bank Guarantee Fund shall select an acquiring entity in a manner that ensures openness, transparency, equal treatment of potential acquiring entities, no conflict of interests, expediency of proceedings and selection of an entity offering the most favourable terms, taking into consideration the resolution objectives in the prevailing market conditions. Acquisition of a bank through forced restructuring may rely on a takeover of three types of properties by the acquirer: firstly, the company or an organised part of the company operated by a bank during the process of restructuring; secondly, the chosen or all of the bank's property rights or liabilities during restructuring; and, thirdly, the share rights of a bank during restructuring. The indicated property substances are transferred to an entity or takeover companies for a fee. Remuneration paid by the acquiring parties for the identified property substances is transferred to the bank or to its shareholders by the Bank Guarantee Fund. The amount of remuneration, however, is transferred after previous deduction of costs of forced restructuring of that bank.

The measure of acquisition of a bank appears similar for a bridge institution as a means of forced restructuring. Creating a bridge institution constitutes an alternative for the means of the takeover of a bank in the restructuring process. The bridge institution forms a special operator on

[11] See Van der ZWET, A. *Crisis Management Tools in the EU: What Do We Really Need?*. Amsterdam: De Nederlandsche Bank, 2011. 32 p. DNB Occasional Studies, no. 2; McGUIRE, C. L. *Simple Tools to Assist in the Resolution of Troubled Banks*. Washington, DC: World Bank, 2012. 135 p. Report, no. 68020; and BINDER, J.-H. Resolution: Concepts, Requirements and Tools. In: J.-H. BINDER and D. SINGH, eds. *Bank Resolution: The European Regime*. 1st ed. Oxford: Oxford University Press, 2016, pp. 25-59. ISBN 978-0-19-875441-1.

the financial market. In fact, it is a bank of a specific legal status. The institution is created in order to continue the activity of the bank under restructuring process. The Bank Guarantee Fund, on the other hand, is the only shareholder or dominant entity in the bridge institution. According to the Article 183 of the mentioned Act, where the bridge institution is a bank, the initial share capital of such bridge institution contributed by the Bank Guarantee Fund must not be less than the equivalent of EUR 1 000 000 in PLN converted as per the average exchange rate announced by the National Bank of Poland, effective on the date of permit to establish a bridge institution. Another feature of the bridge institution is a legally limited period of action. In this limited period of time, the reorganisation of the banking company which has been taken over in the process of restructuring and the disposal of the bridge institution should be carried out. The state of a recession in the economy argues for using a bridge institution in the first place. Due to this state, an immediate disposal of the banking company would lead to an unprofitable bank regulation in the process of restructuring.

The write-down or conversion of the liabilities of the bank is a key for the restructuring process.[12] The use of means of the write-down or conversion of the liabilities of the bank by the Bank Guarantee Fund constitutes the means of a last resort. Write-down or conversion of the liabilities with a view to recapitalising the bank under restructuring shall be admitted if it brings an entity under restructuring in conformity with the requirements of operation defined under other provisions and there are reasonable indications following the restructuring; it will attain a long-term financial stability. As a result, the liabilities stemming from both equity and borrowed capital are terminated without remuneration. The consequence referred to in the preceding sentence is connected with the rule of covering the bank's losses by the shareholders or members of the

[12] About the bail-in mechanism see BLIESENER, D. H. Legal Problems of Bail-ins under the EU's Proposed Recovery and Resolution Directive. In: A. DOMBRET and P. S. KENADJIAN, eds. *The Bank Recovery and Resolution Directive: Europe's Solution for "Too Big to Fail"?*. 1st ed. Berlin; Boston: De Gruyter, 2013, pp. 189-228. ISBN 978-3-11-032107-4; SCHILLIG, M. Bank Resolution Regimes in Europe – Part II: Resolution Tools and Powers. *European Business Law Review*. 2014, vol. 25, no. 1, pp. 67-102. ISSN 0959-6941; THOLE, Ch. *Bank Crisis Management and Resolution – Core Features of the Bank Recovery and Resolution Directive*. Munich: University of Munich, Centre of Advanced Studies, 2014. 22 p.; and AVGOULEAS, E. and Ch. A. GOODHART. *A Critical Evaluation of Bail-in as a Bank Recapitalisation Mechanism*. London: Centre for Economic Policy Research, 2014. 28 p. Discussion Paper, no. 10065. ISSN 0265-8003.

bank in the first place. Civil liability of creditors, however, is subsidiary (ancillary). The mechanism of covering the bank's losses by its shareholders or members in the first place, not by the state, then by its creditors, is referred to as the so-called bail-in or debt write-down. The measures of the write-down or conversion of the liabilities can be used independently or with other means of forced restructuring. Pursuant to the Article 201 paragraph 1 of the Act from the 10th of June 2016, the Bank Guarantee Fund may without the consent of the owners and creditors of an entity under restructuring:

1) write down or convert the liabilities with a view to recapitalising an entity under restructuring;
2) write down or convert the liabilities transferred to a bridge institution with a view to equipping it with own funds;
3) write down or convert the liabilities transferred under an instrument of separation of the property rights; and
4) write down the liabilities under an instrument of acquisition of an undertaking.

Consequently, the write-down or conversion of the liabilities can be complementary to other means of forced restructuring. Write-down of rights attached to shares and write-down or conversion of liabilities shall be effective towards an entity under restructuring and shall concern owners and creditors, regardless of limits and restrictions on assumption of the rights attached to shares and on investing funds.

The last means of forced restructuring of banks is the separation of the property rights of the bank under restructuring or the bridge institution. This measure has a special legal nature – separation of the property rights constitutes a means of a dependent and ancillary nature. The means of separating the property rights can only be applied in conjunction with another ancillary means of forced restructuring. Separation of the property rights is based on transferring the selected property rights and related obligations of the bank under restructuring process or the bridge institution to an asset management vehicle. The Bank Guarantee Fund may transfer back property rights or liabilities to an entity under restructuring or to a bridge institution. The detailed conditions and the mode of transfer as well as of back transfer shall be established by a decision of the Bank Guarantee Fund. On the grounds of the Article 223 of the mentioned Act, the property rights may be separated if:

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1) liquidation of the property rights could have a material adverse effect on the market situation, in particular on prices of such property rights;
2) transfer of the property rights to an asset management vehicle is necessary for continuation of operation of an entity under restructuring or a bridge institution; or
3) transfer of the property rights to an asset management vehicle will increase the revenue from these rights.

The Bank Guarantee Fund may establish an asset management vehicle or a greater number of them in the form of a capital company. An asset management vehicle shall manage the property rights and liabilities transferred thereto from one or several entities under restructuring or from a bridge institution, including their disposals. The transfer of the property rights and liabilities shall follow under a decision of the Bank Guarantee Fund.

Concluding remarks

The analysis of regulations included in the Act on the Bank Guarantee Fund, Deposit Guarantee Scheme and Forced Restructuring has led to the conclusion that forced restructuring constitutes a legally and economically complicated decision-making process. Considering a bank as likely to fail raises a series of legal consequences. Where this circumstance applies, the Bank Guarantee Fund is obliged to evaluate conditions for a decision regarding forced restructuring. The Bank Guarantee Fund makes a decision on forced restructuring of a bank if the protection of the public interest requires so. The proceedings should contribute to implementation of at least one of the objectives of forced restructuring set out in the law. In turn, attaining the objectives to the same degree is not possible as part of the supervisory function or insolvency proceedings. The objectives of the forced restructuring, including maintaining of the financial stability and limitation of the public funds or the probability of their involvement in the financial sector, should refer to the size of the tasks carried out by a national bank. In this view, applying the means of forced restructuring towards banks of a minor relevance for the national financial system may prove unjustified *de lege lata*.

Making a decision on initiating forced restructuring is connected with choosing the means of forced restructuring. In the decision to initiate forced restructuring, the Bank Guarantee Fund is authorised to determine the expected scope and conditions for using the means of forced restructuring. Decisions about specific means of forced restructuring constitute subject of separate decisions. The Bank Guarantee Fund has a variety of means of forced restructuring at its disposal. These means can be implemented in different variants. Banks which operate in the form of both a joint-stock company and a cooperative society can be covered by them. However, in relation to cooperative banks, the catalogue of measures of forced restructuring is limited *de iure*. This results from the inalienable character of a member's share in a cooperative bank. The inalienable member's share cannot be forcibly transferred to an acquiring entity or a bridge institution.

The Bank Guarantee Fund is obliged to adapt the process of forced restructuring to the dynamically changing financial situation and the organisational-legal form of the bank and its economic environment. Therefore, the constructing role of the Bank Guarantee Fund is clear. Selection of adequate means of influence on a bank under the threat of a bankruptcy allows the implementation of the objectives of forced restructuring. Legal means applicable to a bank constitute *de lege lata* methods of achieving the objectives of forced restructuring.

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