

France Implements Bail-In

Summary of the Recovery and Resolution Aspects of the French Banking Reform Adopted on July 18, 2013

July 23, 2013

On July 18, 2013, new bank legislation was adopted in France aimed at the ring-fencing and regulation of certain banking activities. The reform:

- addresses the separation of financing activities and customer services from proprietary trading activities;
- introduces a strengthened supervisory framework, including, critically, bail-in and other resolution powers; and
- provides for other consumer protection measures, such as caps on retail bank fees for certain customer transactions and increased protection of over-indebted consumers.

It also provides for increased disclosure as to banks' and significant non-financial companies' activities in tax havens.

Since France is one of the few European countries to have put in place bail-in measures in advance of the implementation of the European Recovery and Resolution Directive ("RRD")¹, this memorandum focuses on the recovery and resolution aspects of the reform.

Bail-in and Other Resolution Powers

The French banking regulator ACP is being renamed ACPR, standing for *Autorité de Contrôle Prudentiel "et de Résolution"*. The ACPR is charged with supervising and implementing measures for the prevention and resolution of banking crises. It is given very broad powers with respect to "failing banks", as discussed below. The ACPR is entitled to use any of its powers "in a proportionate manner" to achieve the following objectives: (i) to preserve financial stability, (ii) to ensure the continuity of banking activities, services and transactions of financial institutions, the failure of which would have systemic implications for the French economy, (iii) to protect deposits and (iv) to avoid, or limit to the fullest extent possible, any public bail-out. For example, the bail-in mechanism could be implemented together with other resolution measures (including the temporary suspension of Qualified Financial Contracts or "QFCs"²) and, contrary to the RRD, the bail-in is *not* presented as a measure of last resort.

The new law provides for the following resolution powers:

- *Bail-in*: Bail-in would allow authorities to cancel or write-off shareholders' equity and then cancel, write-off or convert into equity subordinated debt and contingent convertible securities (CoCos), in accordance with their seniority. As yet, senior debt is *not* subject to this bail-in power, contrary to the provisions of the RRD.³

¹ See the proposal dated June 28, 2013 for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms.

² Comprised of certain financial instruments and derivative contracts issued by financial institutions and other specified counterparties, as defined under Articles L. 211-36 *et seq.* of the French Monetary and Financial Code (*obligations financières*).

³ Whether or not to include senior debt in the bail-in mechanism was much debated. The issue may be revisited based on the position that will be adopted at the EU level in connection with the RRD.

- *Transfer of assets and activities:* The ACPR will be entitled to transfer all or part of the bank's assets and activities, including to a bridge bank. This automatic transfer occurs by operation of law, without the need for any formality or third party consents. No termination or close-out netting of contracts related to the transferred business can be triggered based solely on such transfer.
- *Forced deleveraging:* The ACPR will have the power to force a bank to issue new equity. We would expect that this would apply without the need for shareholder approval as would otherwise be required by applicable company law.
- *QFCs:* The ACPR may temporarily (until 5pm on the business day following the publication of its decision) suspend the exercise of any acceleration, termination or close-out of QFCs.
- *Suspension of payments:* Payments to creditors may be temporarily suspended.
- *Limit of certain operations:* This includes the very broad (and as yet undefined) power to limit or temporarily prohibit "certain operations".
- *Management and appointment of an administrator:* The ACPR will be able to terminate executives or appoint a temporary administrator (*administrateur provisoire*).
- *Prohibit dividend payments:* The ACPR may temporarily prohibit the payment of dividends.
- *Access to information:* The ACPR may access all relevant information.

In cases determined by the ACPR in its sole discretion to present urgent risks, the ACPR has the power to adopt resolution measures unilaterally, without affording a hearing to interested parties.

Failing Banks

Failing banks are defined in the law as those that, currently or in the near future (i) no longer comply with regulatory capital requirements, (ii) are not able to make payments that are, or will be imminently, due, or (iii) require extraordinary public financial support. Resolution measures can be applied by the ACPR if the bank's failure cannot otherwise be avoided within a reasonable timeframe.

QFCs

In addition to the temporary suspension of the exercise of any acceleration, termination or close-out of QFCs, as explained above, the French banking reform provides that a QFC entered into with a failing institution may only be transferred in its entirety (that is, no cherry-picking) and that no acceleration, termination or close-out netting of a QFC is permitted as a result of a resolution measure, except where such measure orders the transfer of assets which do not include the QFC in question.

Living Wills and Resolution Plans

Recovery and resolution plans are required of credit institutions (and financial investment firms), or groups of credit institutions (and financial investment firms), whose balance sheet exceeds a certain threshold that will be fixed by a decree of the French Government.⁴ Each such bank or banking group must prepare a recovery plan that will be reviewed by the ACPR. The ACPR is in turn required to prepare a resolution plan for such bank or banking group.⁵

Living wills: Recovery plans must set out measures contemplated in case of a significant deterioration of a bank's financial situation. Such plans must be updated on a yearly basis (or immediately following a significant change in a bank's organization or business). The ACPR must assess the recovery plan to determine whether its resolution powers could in practice be effective, and, as necessary, can

⁴ No separate obligation will arise with respect to an entity within the group that is already supervised on a consolidated basis.

⁵ Further, the ACPR can request any other credit institution (or financial investment firm) to prepare a recovery plan when it determines that a specific risk for financial stability arises out of its activity (and we would expect that the entity in question would then become subject to a resolution plan if it fails).

request changes in a bank's organization. More generally, the ACPR will comment on the draft recovery plan and can require modifications.

Resolution plans: Resolution plans must set out, in advance of any failure, how the various resolution powers set out above are to be implemented for each bank, given its specific circumstances.

Deposit Guarantee and Resolution Fund ("FGDR")

The existing deposit guarantee fund is being renamed FGDR, standing for the *Fonds de Garantie des Dépôts "et de Résolution"*. It is expected to be funded by contributions of up to €10 billion by 2020 which, according to the French Government, will be financed by the financial and banking sector.

The FGDR is granted powers to, upon instructions from the ACPR, acquire all or part of the shares of a failing bank, to subscribe to shares in a bridge bank and to support the financing of a failing or bridge bank (including by granting guarantees). Payments made by the FGDR in this context are entitled to "new money priority" (the French equivalent of DIP financing).

Timing

The measures will enter into force as soon as the law is promulgated and published in the *Journal Officiel*, except those which require the publication of some implementing regulation (Government decree or other text). No timetable has been set for the implementing measures but we expect the Government to release a working timetable for implementation.

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