



Restructuring Alert

ALERT

Bank Resolution in Greece

Introduction

The result of Sunday's (5 July 2015) referendum which rejected the latest proposed bailout by the European authorities was unequivocal.¹ The next steps in this crisis are far less clear, ranging from a swift renegotiation of the terms of the bailout together with an injection of liquidity into the Greek banking system in the most benign scenario to, at the other end of the spectrum, Greece exiting the Eurozone and attaining "pariah status" in the international capital markets.

In this client alert we focus on one aspect of the issues facing Greece - the liquidity crisis facing the Greek banks. We discuss bank resolution procedures available to the Greek authorities.

Background

Credit controls were imposed in Greece under the Government Gazette Legislative Act² issued on 28 June 2015 (the "**Control Legislation**"). People in Greece have been getting used to being able to draw €60 a day although in practice many of the cash machines have run out of money or there is a more limited amount of cash which can be dispensed. The Control Legislation originally provided that the Bank Holiday would last until 6 July 2015, which has since been extended to 8 July 2015. Given the lack of liquidity in the banking system, we would expect further capital controls to extend beyond 8 July 2015 until either a new deal is agreed with the relevant EU authorities and Greece's creditors or Greece exits the Eurozone.

Position of the Greek Banks

In recent months Greek banks had increasingly been drawing upon the European Central Bank's ("**ECB**") Emergency Liquidity Assistance ("**ELA**") programme. However the ECB announced on Sunday 28 June 2015 that it would not increase this funding line and commentators expect this facility to be close to exhaustion. On 7 July 2015 the ECB also announced that it would tighten the collateral terms required for Greek banks to access the ELA fund. Accordingly the Greek banking system's liquidity and solvency positions are weak. On 2 July 2015 five Greek banks had their Caa3 deposit and senior unsecured debt ratings placed on review. The withdrawal of capital has been exacerbated by, amongst other things, fears that depositors may have their deposits redenominated into another currency. Moody's estimates that there has been an outflow of circa €44 billion from the Greek banking system since the end of November 2014.

Contacts

Stephen Phillips

Partner, London
stephen.phillips@orrick.com

Scott Morrison

Of Counsel, London
smorrison@orrick.com

Michael Crosby

Partner, London
mcrosby@orrick.com

Raniero D'Aversa

Partner, New York
rdaversa@orrick.com

Douglas Lahnborg

Partner, London
dlahnborg@orrick.com

Nikiforos Mathews

Partner, New York
nmathews@orrick.com

David Syed

Partner, London
dysed@orrick.com

Simon Willis

Partner, London
swillis@orrick.com

¹ 60% of voters voted against the acceptance of the bailout plan

² See <https://www.orrick.com/Events-and-Publications/Pages/A-Short-Guide-to-the-Implications-for-the-Imposition-of-Capital-Controls-in-Greece.aspx>

Strain on the Banking System

We expect that even if there is a bailout deal agreed in short order post referendum, the damage to the economy caused by the long drawn out bailout discussions and the imposition of capital controls together with the withdrawal of liquidity in recent months means that the authorities in Greece and the ECB (who supervise the four most systemically important banks)³ are going to need to look at a full scale restructuring of the banking system in Greece. Currently there are no domestic resources available to recapitalise the banks given the Greek government's current financial condition. Availability under the European Financial Stability Facility to cover potential bank recapitalisation or resolution in Greece was cancelled by the European Stability Mechanism ("**ESM**") when Greece's bailout programme terminated on 30 June 2015⁴. Accordingly any resolution is dependent on additional resources being made available from outside Greece and a resolution on the bail out discussions.

Resolution Procedures

The European Union has adopted a common framework for bank resolution in the form of the European Bank Recovery and Resolution Directive ("**BRRD**"). The BRRD was adopted by the European Parliament on 15 April 2014. We wrote at length on the BRRD in our recent client alert⁵. The BRRD must be transposed into national law by member states by 1 January 2015 although provisions relating to the "bail in" of subordinated creditors by conversion of debt to equity and write down do not become mandatory until 1 January 2016. Greece, in common with a number of other European states⁶, has failed to transpose the BRRD into Greek law at the time of writing. We understand that the law has been drafted and there are constitutional provisions which may allow the passing of this law in a matter of days however.

Existing Resolution Laws

Whilst the BRRD is not in effect in Greece there are some effective legislative tools to implement a resolution. Greece's position is somewhat analogous to that of Portugal in August 2014 which, whilst it had also not transposed the BRRD into law, was able to implement a "good bank" "bad bank" split of Banco Espirito Santo over the weekend of 2/3 August 2014. Specifically, the assets of the bank were transferred to "Novo Banco" over the weekend, leaving the shareholders and subordinated creditors with the old vehicle and the "problem assets". See our client alert attached for additional details of the Banco Espirito restructuring⁷.

The existing bank resolution laws in Greece shares many similarities with the BRRD

In April of 2015, Panellinia Bank⁸ was liquidated under the Greek resolution framework, with selected assets and liabilities sold to Piraeus Bank in an auction procedure. The "good" assets were transferred leaving the "bad" assets behind. Shareholders' claims were not transferred. Accordingly, Greece has a track record of being able to restructure its banks, although the complexity of implementing a systematic transfer of assets into a new bank or banks in the midst of a crisis will be a huge technical challenge.

Specifics of the Resolutions Tools

There are a number of legislative provisions which are currently applicable to Greek credit institutions facing liquidity issues although given the extreme issues of the Greek banks, our alert focuses on the "heavy" resolution tools rather than the "preventative measures" tools which might be available prior to the point of no return. For example, Greek banking legislation includes a provision which allows the Bank of Greece ("**BoG**") to appoint a

³ Under article 4 par. 1 (i) of Council Regulation (EU) No. 1024/2013 (conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions), the relevant task has been conferred to the European Central Bank (the ECB) in relation to the four systemic Greek banks.

⁴ A new ESM programme requires EC/ECB/IMF assessment of debt sustainability and Bundstag approval. The ESM was established in 2012 to provide constant access to financial assistance programmes. It replaced the European Financial Stability Facility (EFSF) and the European Financial Stabilisation Mechanism (EFSM).

⁵ <https://www.orrick.com/Events-and-Publications/Pages/Legacy-Of-Lehman-EU-Bank-Recovery-And-Resolution-Directive.aspx>

⁶ Bulgaria, the Czech Republic, France, Italy, Lithuania, Luxembourg, the Netherlands, Malta, Poland, Romania

⁷ <https://www.orrick.com/Events-and-Publications/Pages/The-Nationalisation-of-Banco-Espirito-Santo-The-Aftermath.aspx>

⁸ <http://www.eba.europa.eu/documents/10180/1057717/Decision+of+the+Bank+of+Greece>

commissioner over a bank to assess a bank's position. In addition, under Articles 136-138 of the Banking Law⁹ a bank may be placed in special liquidation. Our expectation is that resolution is likely to require the need for a separation of good assets from problem assets.

This will likely be effected via Articles 140-142 of the Banking Law. Under these provisions, BoG is empowered to impose certain resolution measures¹⁰ to ensure the financial stability of, and strengthen public confidence in, the Greek financial system. In particular, the BoG may amongst other things:

- a) compel the credit institution to transfer certain assets to another credit institution or entity against consideration (article 141 of the Banking Law). There is an explicit provision in article 141 of the Banking Law (par. 9), pursuant to which if, by virtue of the relevant decision of the BoG, financial collateral arrangements within the meaning of Greek law 3301/2004 are transferred, then such arrangements are mandatorily transferred in their entirety;
- b) recommend that the Greek Minister of Finance establishes a transitional credit institution on public interest grounds, to which all or part of the assets and liabilities of the credit institution will be transferred (article 142 of the Banking Law). The share capital of the transitional credit institution is fully paid by the Hellenic Financial Stability Fund¹¹. The shares of the transitional credit institution are sold through an auction initiated by its board of directors, following a valuation by an independent valuer.

No Worse Off

Note that Article 144 of the Banking Law provides that if a shareholder or a creditor of the credit institution considers that their financial position is worse off due to the imposition of the Article 140-142 measures compared to the financial position that they would have been if the credit institution was placed under special liquidation, such shareholder and/or creditor shall have the right to request compensation from the Greek State. A similar provision is included in article 73 (a) of the BRRD Directive.¹²

Bail-in Measures

Article 6(a) of Greek Law 3864/2010¹³ provides that the government may impose certain "bail-in measures" against a Greek credit institution, upon relevant recommendation by the BoG. Specifically, there are two mandatory measures aimed at allocating the residual amount of the capital shortfall to the holders of its capital instruments and other subordinated liabilities which may be undertaken. These "bail-in measures" could be enforced against, firstly, holders of common shares, then holders of preference shares and other Tier I liabilities and, lastly, holders of other subordinated liabilities, resulting in losses to and/or elimination of the interests of these classes of investors. Article 6(a) of Greek Law 3864/2010 explicitly provides that the implementation of these measures cannot trigger contractual clauses that are activated in case of liquidation, insolvency or other events that can be characterised as credit event or event equivalent to insolvency; and (b) be considered as non-fulfilment or violation of the contractual obligations of the credit institution in order to establish material grounds for the early termination of an agreement by counterparties of the credit institution.

As is the case under Articles 140-142, there is a "no shareholder/creditor worse off rule", if the bail out measures are issued.

The Deposits – the Cyprus Example?

In 2013 in order to receive a €10 billion bailout package the Cypriot authorities agreed to impose significant "haircuts" on depositors holding greater than €100,000 of the main systemically important banks in Cyprus. At the time the authorities responsible for the bailout were heavily criticised as haircuts of depositors were largely

⁹ Greek Law 4261/2014 (the Banking Law)

¹⁰ This task currently remains with BoG. As of 01.01.2016, this task shall be conferred to the Single Resolution Mechanism

¹¹ <http://www.hfsf.gr/en/index.htm>

¹² According to this article, Member States shall ensure that, where the resolution authorities transfer only parts of the rights, assets and liabilities of the institution under resolution, the shareholders and those creditors whose claims have not been transferred, receive in satisfaction of their claims at least as much as what they would have received if the institution under resolution had been wound up under normal insolvency proceedings at the time when the decision referred to in Article 82 was taken.

¹³ As amended by Greek law 4254/2014 in combination with Cabinet Act dated 11 April 2014

unheard of in the context of EU bailouts. The "haircuts" were criticised as unduly harsh compared to over measures taken in the EU. For example concurrent with the events in 2013 the Dutch Bank SNS¹⁴ was recapitalised and whilst shareholders and junior bondholders were expropriated the deposits were untouched.

Conclusion

The next few days will be crucial for Greece and its banking system. A swift negotiation with the EU/IMF/ECB followed by an emergency capital injection into the banking system, possibly in tandem with certain of the resolution measures described above, is conceivable. We are concerned that the use of the ESM to fund a bank restructuring may take considerable time, however and that time is running out for this scenario. A quick conclusion to the negotiations is the best case scenario although alternatives such as an exit from the Eurozone cannot be ruled out however.

We question the political acceptability of depositor bail-ins on the scale imposed in Cyprus. Given the extent of the problem of the Greek banks, we would expect that such a scenario cannot be ruled out.

The coming few days are crucial given the liquidity status on the banks. The next pressure point in this long-running saga is 14 July 2015 where payments of ¥11.67 billion are due in relation to Japanese loan repayment. Whilst a small amount in the context of Greek debt, the concern would be that non-payment of this amount may, after the relevant grace period, trigger cross defaults of other bonds, the so called "hold out bonds", which did not take part in the 2012 restructuring. The Greek government may wish to make this payment in an attempt to maintain the current status quo whilst it considers negotiations are ongoing. Finally, on 20 July 2015 a payment of €3.5 billion is due to the ECB. Failure to pay this amount will likely be considered by the markets as a "credit event" which may trigger pay-outs under Greek sovereign Credit Default Swaps ("CDS").

Permission is granted to make and redistribute, without charge, copies of this entire document provided that such copies are complete and unaltered and identify Orrick as the author. All other rights reserved.

Orrick, Herrington & Sutcliffe (Europe) LLP is a limited liability partnership registered in England and Wales under number OC347108 and is a multinational practice of registered and foreign lawyers and English solicitors. The term partner is used to refer to a member of Orrick, Herrington & Sutcliffe (Europe) LLP or an employee or consultant with equivalent standing and qualifications, or an individual with equivalent status at an Orrick Entity. A list of members of Orrick, Herrington & Sutcliffe (Europe) LLP and their professional qualifications is open to inspection at our registered office, 107 Cheapside, London EC2V 6DN. Authorised and regulated by the Solicitors Regulation Authority. Orrick, Herrington & Sutcliffe (Europe) LLP or an affiliated undertaking (each such undertaking being an "Orrick Entity") has an office in Beijing, Berlin, Brussels, Dusseldorf, Frankfurt, Hong Kong, London, Los Angeles, Milan, Moscow, Munich, New York, Orange County, Paris, Portland, Rome, Sacramento, San Francisco, Seattle, Shanghai, Silicon Valley, Taipei, Tokyo and Washington, D.C.

This publication is designed to provide Orrick clients and contacts with information they can use to more effectively manage their businesses and access Orrick's resources. The contents of this publication are for informational purposes only. Neither this publication nor the lawyers who authored it are rendering legal or other professional advice or opinions on specific facts or matters. Orrick assumes no liability in connection with the use of this publication.

Attorney advertising. As required by New York law, we hereby advise you that prior results do not guarantee a similar outcome.
© 2015 Orrick, Herrington & Sutcliffe LLP, 51 West 52nd Street, New York, NY, 10019-6142, +1-212-506-5000.

¹⁴ See <http://blogs.orrick.com/distressed-download/tag/sns-reaal-group/>