



EUROPEAN CENTRAL BANK

EUROSYSTEM

08 February 2010

COMMISSION COMMUNICATION ON “AN EU FRAMEWORK FOR CROSS-BORDER CRISIS MANAGEMENT IN THE BANKING SECTOR”: EUROSISTEM’S REPLY TO THE PUBLIC CONSULTATION

INTRODUCTION

On 20 October 2009, the European Commission launched a public consultation on a Communication regarding “An EU framework for cross-border crisis management in the banking sector”, which contains a range of issues related to three main areas: i) early intervention involving actions by supervisors aimed at restoring the stability and financial soundness of an institution when problems are developing, together with intra-group asset transfer between solvent entities for the purposes of financial support; ii) bank resolution, namely measures taken by national resolution authorities to manage a crisis in a banking institution, to contain its impact on financial stability and, where appropriate, to facilitate an orderly winding up of the whole or parts of the institution measures; and iii) insolvency proceedings covering reorganisation and winding up that take place under the applicable insolvency regime. Moreover, the ECOFIN endorsed a set of Conclusions on 2 December 2009 that contain orientations for the Commission’s work in the short-to-medium term as regards the three above-mentioned areas.

Against this background, this note provides the Eurosystem’s stance on the aforementioned Communication.

Since the unfolding of the financial crisis, the national legal and institutional arrangements in a number of Member States have been amended with the aim of improving the framework for prudential supervision and financial stability. As reflected also in ECB opinions provided in accordance with the EU Treaties, the Eurosystem has generally supported such improvements. However, the greater interdependencies between national financial systems and the need to safeguard of the process of EU financial integration *require appropriate action at EU level to address the possible systemic impact of failing cross-border financial institutions*. Therefore, the Eurosystem supports the objective of the Commission to take initiatives for developing an EU resolution framework and addressing obstacles to the effective management of crisis of EU cross-border financial institutions.

Following the order of the questions in the Commission’s Communication, Section 1 deals with early intervention tools; Section 2 focuses on issues related to intra-group asset transfers; Section 3 and 4 highlight the Eurosystem’s stance as regards issues concerning bank resolution and insolvency.

1. EARLY INTERVENTION TOOLS (SECTION 3.1 OF THE COMMUNICATION)

1.1 Which additional tools should supervisors have in order to address developing problems?

1.2 How should their use be triggered?

1.3 How important are wind-down plans ("living wills") as a tool for crisis management?

The Commission proposes increased convergence as regards the early intervention tools available to supervisors, to be possibly incorporated in Article 136 of the Capital Requirements Directive¹. *The Eurosystem concurs with the objective to ensure that all national supervisors have adequate tools to identify problems in banks at an early stage and take adequate action with the aim of reducing the likelihood of bank failure.* The work conducted by the Committee of European Banking Supervisors (CEBS) and in particular the mapping of supervisory objectives and powers prepared in March 2009 is an important starting point for assessing the minimum set of tools which all the supervisory authorities should have at their disposal. At the international level, work in progress on these issues, for instance by the Basel Committee on Banking Supervision through its Cross-border Bank Resolution Group (CBRG), also offers useful input.

When considering additional tools for supervisors, the following considerations should be taken into account.

First, in general it is not always possible to make a clear distinction between instruments available for intervention in normal situations and those available in a crisis, as in practice it is difficult to determine at which phase a particular supervisory measure will be required. For example, in an emergency situation, a resolution measure - such as rapid recapitalisation - may be required at an early intervention phase, even though the bank is not in breach of any prudential requirements. Conversely, a suspension of payments by a bank may effectively mean closing it down, as third parties would be concerned in continuing to do business with the affected bank. This entails that *the authorities' toolbox should allow a gradual increase of their possible tools in conjunction with the intensification of the bank's problems.*

Second, the identification of a minimum set of tools should be the basis for an improvement in the cooperation among supervisors when addressing a cross-border group in a crisis situation. To achieve this aim, particularly in a cross-border crisis, there should be a clear reciprocal understanding and communication, among the supervisory authorities involved, of the legal consequences that a certain measure would entail for the bank affected. In fact, a review conducted by the Banking Supervision Committee on the types of reorganisation measures available under national laws showed significant differences among Member States. For instance, the appointment by the supervisor of an administrator to oversee the bank can be kept secret in certain Member States but not in others. Therefore, *further*

¹ Directive of the European Parliament and the Council relating to the taking up and pursuit of the business of credit institutions (recast) of 14 June 2006 (2006/48/EC), OJ L 177, 30/06/2006, p.1, as amended.

harmonisation as regards the types of reorganisation measures, including common terminology at EU level may greatly help to foster supervisory cooperation.

Third, conditions should be identified for the implementation of early intervention tools, also in the light of possible legal challenges. In order to strike a balance between financial stability concerns and the protection of bank stakeholders' rights, some early intervention tools may be subject to qualitative preliminary conditions as safeguards for such rights. However, given the need for the authorities to retain the necessary degree of flexibility in responding to a crisis, there should be no automatism in the conditions triggering certain supervisory decisions.

In its Communication, the Commission asked for specific comments on wind-down plans (or "living wills") as a tool for crisis management. *In general, the preparation of recovery and resolution plans may benefit the effective management and the continuing resilience of financial firms as well as the ability of supervisory authority to act in a crisis situation.* The definition of such contingency plans would in particular contribute to the ability of financial institutions to identify situations where corporate structures may have become too complicated or misaligned with the adopted business model and therefore be a useful internal management tool. In addition, such plans would trigger a dialogue with the bank that could foster a better understanding of the group's organizational structure by the supervisory authority. This knowledge could facilitate the action of the competent authorities, should a reorganisation or resolution process become necessary. However, full compliance should be ensured with the fundamental freedoms under the EU Treaties to provide services and to establish in any EU Member State. Finally, the mere existence of resolution plans could help to reduce moral hazard, as it would make clear that authorities can take action in a crisis situation, including if necessary winding down an ailing financial firm.

2. INTRA-GROUP ASSET TRANSFERS (SECTION 3.2 OF THE COMMUNICATION)

2.1 Is the development of a framework for asset transfer feasible? If so, what challenges would need to be addressed?

The transfer of collateral and other assets within a cross-border banking group may facilitate liquidity management within such a group. In some cases the possibility to transfer assets within the group may enable a cross-border group to survive. However, when evaluating the benefits of these transfers within a cross-border banking group the possible contagion risk should be taken into account. In this context, *the Eurosystem notes that the ECOFIN Conclusions adopted on 2 December 2009 requested that the Commission's work should aim at exploring an EU framework for asset transfers with the necessary safeguards.*²

Currently the transferability of collateral and other assets within a cross-border banking group is limited by several legal barriers arising from both EU and national law. More specifically, the main obstacles arise from company law (company interest, capacity, shareholder approvals, creditor protection, directors'

² According to the ECOFIN Conclusion adopted on 2 December 2009 "This work should in particular explore mechanisms to disincentivise ring fencing practices, including exchange of information, enhanced coordination practices and legal provisions."

liability etc.) and insolvency law (provisions for the protection of creditors such as concerning fraudulent and ‘suspect period’ transfers), potentially triggering in some cases criminal sanctions (e.g., imprisonment) and/or civil fines (e.g., responsibility of directors). Experience suggests that care should be taken to ensure that any such measures do not serve to increase the vulnerability of the subsidiary or branch making the transfer.

In general, many of the legal problems arise because the concept of a group interest does not exist in many jurisdictions and its interaction with corporate and insolvency laws may give rise to legal uncertainties. Moreover, it should be taken into account that provisions of company and insolvency law may be justified by specific reasons (i.e. protecting creditors or enabling additional funding for each separate enterprise within the group). *Some of the legal obstacles that would need to be addressed are listed in the Annex.*

Obstacles to the transfer of assets within a cross-border group may also derive from ring-fencing measures adopted by supervisory authorities. It should be further assessed whether limitations on such supervisory powers could be introduced, provided that there are no specific risks for the subsidiary or the branch concerned. The college of supervisors and the foreseen European Banking Authority may play an important role in alleviating problems in that respect.

In conclusion, *any regime that would seek to facilitate binding intra-group asset transfers would be challenging from a legal perspective.*

2.2 What safeguards for shareholders and creditors are needed?

In order to be legally feasible, any intra group transfer regime would have to provide minimum protection for the rights of shareholders and creditors of the entity ordered to transfer assets, whose financial situation could be worsened by the transfer. Generally, the legal regime should ensure fairness for stakeholders and be proportional, transparent and legally certain. Possible safeguards for shareholder and creditor rights in a future regime on intra group transfers include:

- rules on valuation of the assets to be transferred;
- imposing a solvency test and a necessity test on the transferor as pre-conditions for the transfer;
- giving a priority claim to the shareholders and creditors of the transferor against the pre-existing creditors of the transferee in case of later insolvency;
- a ‘claw back’ regime for creditors, adversely affected or prejudiced by an undervalued transfer, if the transferor should become insolvent; and
- prior notification of the relevant authorities.

As in the case of the compensation upon the taking of shareholder property, shareholders should also have the right to challenge the valuation of the assets and under certain conditions the transfer itself. Moreover, a higher level of protection of shareholder and creditor rights would include certain key conditions – for

instance the requirement that any such intra group transaction must be “at arm’s length” (i.e., the terms of the transfer must be as favourable to the transferee as those it could have concluded with an entity outside the group). Moreover the creation at the EU level of a new concept of a banking or financial group, in which the transferor would have special status and stakeholder rights, might be also considered.³ The problems arise from the conflict between, on the one hand, the economic reality of the business model of the banking groups, organised in a centralised manner, and, on the other, the application of fundamental legal concepts under company and insolvency laws as well as the supervisory responsibilities of national authorities, which are necessarily focused on the rights and responsibilities of the separate legal entities.

As the ECB President has noted recently “in this context, the idea of giving supervisors power to shuffle assets around between separate entities in a group, ignoring their legal personality, requires renewed discussion in legal circles..... at a very basic legal level, legal persons are the bearers of rights and obligations, and any attempt to facilitate asset transfers at a serious under-value within the different legal personalities of a banking or financial group will raise a host of legal problems under company, insolvency, supervisory and even criminal laws, and also undermine the legitimate expectations of third parties in the financial markets....”⁴.

3. BANK RESOLUTION (SECTION 4 OF THE COMMUNICATION)

- 3.1 What should be the key objectives and priorities for an EU bank resolution framework?***
- 3.2 What are the key tools for an EU resolution regime?***
- 3.3 What are the appropriate thresholds for the use of resolution tools?***
- 3.4 What should be the scope of an EU resolution framework? Should it only focus on deposit-taking banks (as opposed to any other regulated financial institution)?***
- 3.5 If so, should it apply only to cross-border banking groups or should it also encompass single entities which only operate cross-border through branches?***

The Eurosystem supports the notion that national authorities should have appropriate tools to deal with financial institutions in difficulty, so that an orderly resolution can be achieved that helps maintain financial stability, minimise systemic risk, protect consumers, limit moral hazard and promote market efficiency. In principle such tools should apply to all financial institutions, as the financial crisis has shown that systemic risks may quickly spread through the financial system and that it is necessary to prevent a crisis at one institution from spreading to other. However, the Eurosystem notes that the objectives may be different across sectors; for instance as regards banks it would be crucial in a crisis situation to ensure the protection of deposits and key banking services for the clients. .

³ On the one hand it could be argued that the indeterminate notion of ‘group interest’ should never overrule the company interest. Others strongly argue that any intra group transfer regime, impacting as it does fundamental property rights, would require a unified, comprehensive regime ensuring fair treatment for all parties. They concede however this would be difficult to achieve.

⁴ ECB president’s opening address at the colloquium “La justice face a la crise”, Cour d’Appel de Paris, 7 December 2009. The President’s speech is available on the ECB website www.ecb.europa.eu.

In this context, *an EU framework for resolution should entail the following priorities*: (i) the development of a minimum toolkit for national competent authorities to address problems in an ailing bank, without necessarily resorting to public support, and facilitating a private sector solution or, when deemed appropriate, liquidate the bank without negative effects on financial stability; (ii) enhanced coordination and cooperation among national authorities, in particular when dealing with cross-border groups. This would strengthen the single market for financial services and maintain a level playing field.

As regards the key tools of an EU resolution regime, recent legislative reforms at the national level as well as analysis conducted at international level (CBRG, IMF) indicate that the toolbox of measures of the competent authorities should include the power to: (i) take control of an ailing financial institution in order to facilitate or effect the transfer of all or part of the shares of an ailing financial institution to a private sector purchaser or temporarily to the government to restructure it; (ii) restructure and transfer assets, liabilities and business operations to other institutions or a ‘bridge bank’ with the objective to ensure the continuity of systemically important operations; and (iii) transfer illiquid or risky assets to a ‘bad bank’ arrangement to isolate problematic assets that would hinder the restructuring of the bank.

The Eurosystem agrees with the Commission that *clear threshold conditions, qualitatively defined, are central to an EU resolution regime*. They should be inspired by the concern to maintain a graduated approach to resolution allowing for sufficient flexibility for the authorities.

Furthermore, a key feature of an effective and orderly bank resolution is its ability to deal with the problem of the bank counterparty’s termination rights under contractual rights. In particular, Directive 2002/47/EC on financial collateral arrangements⁵ (the ‘Financial Collateral Directive’) does not currently permit any delay against non-defaulting counterparties exercising netting and close-out rights. As recommended by the CBRG, “the national resolution authorities should have the legal authority to temporarily delay immediate operation of contractual early termination clauses in order to complete a transfer of certain financial market contracts to another sound financial institution, a bridge financial institution or other public entity. Where a transfer is not available, authorities should ensure that contractual rights to terminate, net, and apply pledged collateral are preserved. Relevant laws should be amended, where necessary, to allow a short delay in the operation of such termination clauses in order to promote the continuity of market functions.” Accordingly, the case should be considered for amending the Financial Collateral Directive to permit a short delay in the exercise of immediate close-out rights in order for resolution authorities to be able to complete such transfers. To ensure sufficient legal certainty, the aim should also be to find a solution at the global or G-20 levels.

⁵ Directive of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements (2002/47/EC), OJ L 168, 27.06.2002, p.43, as amended.

3.6 Is it necessary to derogate from certain of the requirements imposed by the EU Company Law Directives, and if so which conditions or triggers should apply to any such derogation? What appropriate safeguards, review or compensation mechanisms for shareholders, creditors and counterparties would be appropriate?

In an extreme situation involving the public interest – such as a threat to financial stability, depositor protection or the integrity of the financial markets - *the competent authority should be entitled to derogate from a number of provisions of the 2nd Company Law Directive⁶, the Takeover Bids Directive⁷ and the Shareholders’ Voting Rights Directive⁸*, adherence to which may delay or even block the rapid recapitalisation or the restructuring of a failing bank.⁹ Recent cases, such as the restructuring of Fortis in late 2008 and Hypo Real Estate in 2009, illustrate that the application of such company law requirements may result in substantial delays to the restructuring plan agreed by the competent authorities. Currently the case law of the Court of Justice does not make any exception, even in a crisis, to the requirement under Article 25 of the 2nd company law directive to hold a general meeting for any proposal to increase capital (C-441/93 *Panagis Pafitis and Others v. Trapeza Kentrikis Ellados A.E. and Others* [1996] ECR I-1347). Thus, there is legal uncertainty whether restructuring measures which affect share capital -- such as recapitalisations when effected without holding a general meeting, or subject to substantially reduced shareholder rights -- are compatible with the 2nd company law directive.

Moreover, the requirement under the Takeover bids directive -- to make a mandatory bid for the remaining shares when the threshold level of control is reached -- may trigger additional costs for the public purse upon a decision to take-over a failing bank in the interests of financial stability.

The conditions for a derogation from EU requirements should be based on the need to protect important public interests, i.e. avoid a threat to financial stability and ensure depositor protection or market

⁶ Second Council Directive of 13 December 1976, on the coordination of safeguards which, for the protection of the interests of members and others, as required by Member States for companies within the meaning of the second paragraph of Article 58 of the Treaty, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital with a view to making such safeguards equivalent (77/91/EEC) (Official Journal L 026, 31.01.1977, p. 1-13).

⁷ Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids, Official Journal L 142, 30/04/2004 p.12 – 23.

⁸ Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies, OJ L 184, 14/07/2007 p. 17.

⁹ The provisions of EU directives from which Member States should be entitled to derogate in a financial crisis situation include the following: (1) Article 25 of the 2nd company law directive 77/91/EC which provides that any increase on capital for cash must be decided upon by general meeting; (2) Article 30 of the 2nd company law directive 77/91/EC which provides that any reduction in subscribed capital must except under court order be subject to at least a general meeting decision; (3) Article 29.1 of the 2nd company law directive 77/91/EC which provides that whenever the capital is increased by consideration in cash, the shares must be offered on a pre-emptive basis to shareholders in proportion to the capital represented by the shares; (4) Article 5 of the ‘Takeover bids’ directive 2004/25/EC, which imposes the obligation for any entity which has acquired a threshold level of control of a publicly listed company to make - and the reciprocal right of the remaining shareholders to receive - a public bid for the remaining shares; (5) the provisions of directive 2007/36/EC on the exercise of certain rights of shareholders in listed companies (so called ‘shareholders rights directive’), which establish minimum procedural requirements for general meetings in particular on the convocation periods and the form of the convocations; and (6) the provisions of the 3rd company law directive 78/855/EC and of the 6th company law directive 82/891/EC requiring companies which it is proposed to merge or divide into separate entities respectively to call a general meeting.

integrity. The determination of how extreme the situation would have to be to warrant the taking of such a measure, and hence the application of the derogation(s), should be left to the discretion of the competent authorities. If such derogations were to be introduced, consideration would also need to be given to whether, in view of the extensive intrusion of such derogations into shareholders' property and other basic rights, they should be accompanied by an EU framework on shareholder rights of compensation in cases of bank restructuring. To mitigate moral hazard, an EU framework should ensure that compensation for shareholders is based on the presumption that no resolution tools have been used.

3.7 How can cooperation and communication between authorities and administrators responsible for the resolution and insolvency of a cross border banking group be improved?

3.8 Is integrated resolution through a European Resolution Authority for banking groups desirable and feasible?

3.9 If this option is not considered feasible, what minimum national resolution measures for a cross-border banking group are necessary?

3.10 What is the most appropriate way to secure cross-border funding for bank resolution measures? What role is there for specific private sector funding?

3.11 Is establishing ex-ante crisis funding arrangements practical? If not, how could private sector solutions best address the issue? Is there scope to achieve greater clarity on burden sharing? If so, would the first priority be to define principles for burden sharing?

The Communication lays down two possible options for the enhancement of the application of resolution measures to cross-border banks, namely: (i) to develop a framework for the coordination of measures that would continue to be applied at the national level and (ii) to provide for an integrated resolution of cross-border groups by a single resolution authority.

The Eurosystem favours a realistic approach. As regards the idea of establishing a single EU resolution authority, although conceptually appealing, this would require addressing and finding a European solution to a host of issues arising from institutional, procedural and substantive (insolvency) law. In particular, in order for a fully fledged EU resolution authority to be effective, it would need to operate on the basis of a single EU bank insolvency and resolution code. Without such a single code, the resolution authority would have to deal with twenty seven different insolvency regimes. However, the preparation of a single code for insolvency and resolution - although highly beneficial in principle - seems hardly feasible at least in the short term, as insolvency regimes differ substantially across Member States.

There is a realistic alternative to going down the inevitably complicated process that would be involved in establishing a single authority and harmonised bank insolvency code. This is to work on the coordination of the actions of national resolution authorities involved in the resolution of a cross border banking or financial group. The task of promoting practical cooperation and coordination between national resolution authorities involved in cross border resolutions could be conferred on a specific body or authority created under EU law. Alternatively the task could be conferred on the Cross Border Stability Groups. In either

case this task should not prejudice the application of underlying national resolution laws. Indeed, conferring such tasks on the Cross Border Stability Groups would complement the harmonisation of the tool kits of national resolution authorities.

At the moment, it remains the case that the resolution of a crisis involving a cross-border banking or financial group would involve the application of potentially different resolution measures to group entities in the various jurisdictions. In this context, the coordination between such different procedures could be facilitated by a process of institutional convergence, with an enhanced role for the resolution and supervisory authorities within the resolution process, by recognising in particular their leading role in the administration of ailing financial institutions, in full respect of the due role of the judicial system. The attribution of extensive powers to the resolution and supervisory authorities would be the basis for enhanced information sharing, cooperation and coordination within the colleges of supervisors and cross-border stability groups and crisis management groups as regards the resolution of cross-border banking groups. In particular, such enhanced cooperation could facilitate the appointment of the same insolvency administrator for all the companies that are part of the banking group, when a uniform conduct of the resolution process across the different Member States concerned is deemed appropriate.

The crisis management and resolution framework should aim at reducing to the minimum the possible burden for taxpayers arising from any crisis of financial institutions. In this respect, *the involvement of private sector financing in resolution would be beneficial, also in order to reduce moral hazard in the future*. Moreover, this is in line with the orientations given by the G20 Leaders in the Pittsburgh Summit.¹⁰ *The Eurosystem supports the Commission's intention to further explore the feasibility of establishing mechanisms that could ensure that private sector funds would be available at the time of a crisis*. In many Member States an important role in crisis resolution is played by the deposit guarantee schemes (DGS), funded by the national banking system. The Eurosystem recalls its position, expressed in the context of the Commission's review of the EU framework on DGS, that further efforts could be devoted to identifying additional tasks that may be delegated to DGS, subject to harmonised rules.¹¹

Finally, as regards burden sharing, it is recalled that the ECOFIN on 2 December 2009 invited the Economic and Financial Committee to continue its work on an EU policy coordination framework for crisis management, including the issue of burden sharing, and present concrete proposals to the Council in spring 2010. The Eurosystem looks forward to contributing to such discussions, in order to define an approach to burden sharing that would contribute to reducing moral hazard.

¹⁰ G20 Leaders' statement, the Pittsburgh Summit, 25 September 2009: "We should develop resolution tools and frameworks for the effective resolution of financial groups to help mitigate the disruption of financial institution failures and reduce moral hazard in the future".

¹¹ See "The Eurosystem's stance on the Commission's consultation document on the review of directive 94/19/EC on deposit-guarantee schemes", 13 August 2009 (published on the ECB website).

4. INSOLVENCY (SECTION 5 OF THE COMMUNICATION)

4.1 Is a more integrated insolvency framework for banking groups needed? If so, how should it be designed?

4.2 Should there be a separate and self contained insolvency regime for cross-border banks?

Whilst it would be useful to have an integrated regime at the EU level, especially for cross-border deposit taking banks, it would be difficult to reach a harmonised regime in the area of insolvency law. In the short term, it appears more fruitful *to concentrate on initiatives that improve coordination between supervisors and other administrative and judicial authorities involved in bank reorganisation measures at the national level*. This would be in line with the CBRG's recommendation that "each jurisdiction should establish a national framework to coordinate the resolution of legal entities of financial groups and financial conglomerates within its jurisdiction".

A more formalised EU structure for judicial cooperation in insolvency proceedings involving different entities in a banking group would be needed in this respect. In particular, EU insolvency courts should be legally authorised to share information with insolvency courts in other EU jurisdictions that are dealing with the insolvency of other legal entities of the same EU cross border banking group.

At the same time, the limits of coordination as regards insolvency proceedings applied to cross-border banks must be recognised, considering that insolvency regimes are centred on the legal entity of the bankrupt debtor.

ANNEX

LEGAL OBSTACLES TO INTRA-GROUP ASSET TRANSFERS

Many of the legal problems to intra-group asset transfers arise because the concept of ‘group interest’ does not exist in many jurisdictions and its interaction with corporate and insolvency laws may give rise to legal uncertainties. Some of the legal obstacles that would need to be addressed are summarised as follows.

- Insolvency regimes are centred on the legal personality of the debtor-bankrupt entity. Insolvency proceedings are centred on the equal and fair treatment of creditors’ claims against the debtor’s legal entity and this implies the satisfaction only of the depositors and other creditors of that entity and not of any other entity (e.g. a foreign subsidiary). Thus the insolvency proceedings do not take into account the wider public interest of the financial stability of the group which the debtor entity may be part of.
- Insolvency regimes include rules rendering transfers within a certain ‘suspect’ period prior to insolvency or upon preferential terms retroactively voidable or non-effective at the behest of creditors of the insolvent entity (so called ‘claw back’ rules). Insolvency regimes include rules prohibiting or rendering voidable fraudulent transfers within a certain period prior to insolvency. Creditors may file a civil action to ask the court to render such transfers null and void. The rules on such claims vary between Member States and reflect sensitive public policy choices.
- Insolvency regimes include ‘priority’ rules which affect creditor rights, i.e. treatment of unsecured and secured claims. At present *pari passu* (equal in right of payment) treatment of unsecured, unsubordinated creditors is generally required within insolvency proceedings. Secured creditors and certain privileged claimants (e.g. employees, the State in respect of its tax claims) are generally dealt with separately and ahead of other ‘ordinary’ claimants. These rules might be subverted by a transfer of assets which benefits a particular creditor ahead of the rest e.g. the transferee in the group which is in need of financial assistance.
- In company law, the whole area of minority shareholder rights, which is largely one of national competence, may provide obstacles to intra-group asset transfers. Hence, transactions with connected persons, e.g. a guarantee or transfer of assets from a subsidiary to the holding company, could be challenged by shareholders of the transferring company on grounds of unfair prejudice, e.g., the claim that it was favourable to the majority shareholder and not to the company.
- Directors are under fiduciary duties to act in the interests of their company (i.e. even if this may be contrary to the interests of the group as a whole) and to consequently use company assets only to advance company objectives. In some Member States if the directors fail to show that they

have fulfilled this duty, a court may upon request rescind the contracts concluded by the company with other parties.

- Under company law, there are rules requiring transactions between related entities to be conducted at arms' length (also often a requirement for purposes of tax, conflict of interest rules, etc.).
- Asset maintenance requirements are currently regarded as a useful tool for protecting creditors of home banks and branches of foreign banks. 'Ring fencing', i.e. supervisory actions designed to protect the capital of the failing entity, is commonly used when the domestic supervisor sees a risk or threat of insolvency of the bank that it is supervising and/or of financial instability.
- There are supplementary supervisory constraints on intra group transactions under Article 8 of Directive 2002/87/EC on 'financial conglomerates', which enable supervisors to set quantitative limits and qualitative requirements for intra group transactions of regulated institutions (e.g. credit institutions) in a financial conglomerate.
- The domestic law in certain Member States prohibits or renders voidable certain transactions between connected entities, e.g. companies belonging to the same group (e.g., in Belgium, where there is the concept of the voidable 'free act', and in France, where there are restrictions on up-stream and cross-stream guarantees).

© European Central Bank, 2010

Address: Kaiserstrasse 29, 60311 Frankfurt am Main, Germany

Postal address: Postfach 16 03 19, 60066 Frankfurt am Main, Germany

Telephone: +49 69 1344 0; Website: <http://www.ecb.europa.eu>; Fax: +49 69 1344 6000

All rights reserved. Reproduction for educational and non-commercial purpose is permitted provided that the source is acknowledged.

ISBN 978-92-899-0622-7 (online)