



Banks' Resolution Regime **Formulating the law through successful litigation**

By Dr. Pavlos Neofytou Kourtellos

The financial crisis in Cyprus resulted among others in the introduction of the Insolvency Framework, comprising of a package of six bills of legislation that came into force on the 07/05/2015. New practices emerged from the financial realities focused on corporate insolvency in a more complicated level involving high net wealth credit, banking and financial institutions and the implementation of the Bank Recovery and Resolution Directive (Directive 2014/59/EU) ("**BRRD**"). The BRRD was adopted by the European Parliament on 15 May 2014 to provide authorities with comprehensive and effective arrangements to deal with failing banks at national level, as well as cooperation arrangements to tackle cross-border banking failures.

A response to the global financial crisis and designed to provide an EU-wide and credible recovery and resolution framework to deal with failing financial institutions in a way which obviated the need (to the greatest extent possible) to have resort to taxpayers' money, the BRRD establishes a Cyprus-style bail-in framework for the recovery and resolution of credit institutions and grants authorities a set of powers to intervene in the operations of banks to avoid them failing. If they do face failure, authorities are equipped with comprehensive powers and tools to restructure them, allocating losses to shareholders and creditors following a clearly defined hierarchy. They have the powers to implement plans to resolve failed banks in a way that preserves their most critical functions and avoids taxpayers having to bail them out. Article 28 of the BRRD requires member states to ensure their regulators have the power to remove and/or replace the board of directors and senior management of an institution under certain circumstances. Further BRRD requires member states to give effect to the resolution measures elected by the regulatory authorities of other member states, including the appointment of a special administrator and the exercise of his powers over the assets of the entity or branch concerned. In particular recital (101) of the BRRD provides that effective resolution of internationally active institutions and groups requires cooperation between the Union, Member States and third-country resolution authorities. Cooperation will be facilitated if the resolution regimes of third countries are based on common principles and approaches that are being developed by the Financial Stability Board and the G20.

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A pure example reflecting – and testing - the above into the legal and financial reality is the Resolution Decree of the Central Bank of Cyprus No. 356/14 issued on 21.07.2014 applying resolution measures in respect to the Cyprus Branch of FBME Bank Ltd. On 15.07.2014 the Financial Crime Enforcement Network of the US Department of Treasury ("**FinCEN**") issued a Notice of Finding that reasonable grounds existed for concluding that FBME was a financial institution "*of primary money laundering concern*" pursuant to Section 311 of the USA PATRIOT Act, codified at 31 U.S.C. § 5318A.

The Resolution Decree was adopted because of the consequences and risks that arose on account of the FinCEN Notice of Finding and, more specifically, because of the repeated and direct reactions of Correspondent Banks to that Notice of Finding. As far as the Branch is concerned, the Notice of



Finding, followed by the [FBME NPRM](#) created a direct and catalytic impact on the ability of the Branch to fulfill the very large current liabilities it had in USD currency. The imposition by FinCEN of the Fifth Special Measure and the measures taken by the Correspondent Banks as a result, resulted in the Branch facing serious problems in meeting its obligations towards depositors and creditors, with a potential negative impact on other credit institutions and a concern of financial instability in the Republic of Cyprus. Through the Branch's operations and its Treasury function placing deposit funds with correspondent banks in other member states, FBME had submitted itself and the Branch to EU law, including the BRRD which requires member states to give effect to the resolution measures elected by the regulatory authorities of other member states, including the appointment of a special administrator.



As a result of the Resolution Decree a Special Administrator was appointed by the CBC. Our law firm has been appointed (such appointment having been approved by the Central Bank of Cyprus) as the special legal counsels (both litigation and consultancy) to the appointed Special Administrator of the Cyprus Branch. A team of our firm is heavily engaged in matters dealing with FBME. Amongst other legal issues raised is the implementation of the BRRD to the domestic law, depositors' rights and cross-border insolvency recognition questions. A variety of litigation issues emanating from the principles behind the resolution legislation and the powers and role of a Special Administrator in general have led to the identification of various legal issues and the formulation of the relevant legal principles.

The Supreme Court's approach reaffirmed the principles on the limited residual powers of the directors of a company under special administration. Pursuant to the Resolution Law, the Special Administrator can exercise the powers of the board to bind the Branch, with the powers of the board being essentially suspended save to the extent to challenge the validity of the Resolution Decree and the appointment of the Special Administrator. By no means would the Supreme Court negate the application of the Resolution Law and this is affirmed by the fact that an injunction sought to this effect (stay of the Resolution Decree resolution measures) has been rejected, thus the Special Administrator is the only party able to manage and deal with the Branch assets.

In other cases it was held that the Court cannot obstruct (in the form of an interim procedure) with the force and scope of Regulatory Acts and the Law of the Legislative and Executive Powers, considered as necessary measures so as to avert threats and situations, according to the Decree regarding the Cyprus Branch of FBME Bank Ltd.

Depositors' aggressive motions for summary judgments have been rejected, the Court commenting that "The dispute *has been transformed from an apparently simple contractual dispute of private law to a wider public dispute with substantial administrative procedural law elements and private law, due to the circumstances which arose after the conclusion of the agreements at issue because of the aforesaid consolidation process*".



Courts within jurisdiction and also abroad had the chance to examine issues pertaining to the *locus standi* of the Special Administrator. In one instance the Special Administrator had filed an application to intervene legal proceedings. The following abstract from a recent judgment perfectly highlights the role of the Special Administrator: *“In accordance to the Resolution of Credit and other Institutions Law 17(I)/13, the special administrator has a legal duty to take every reasonable step, with aim to promote the objectives of the resolution and the more efficient performance of the measures resulting thereof, until the completion of the process of implementation (of the measures) upon the institution under resolution and/or the observance of its liquidation in accordance with the insolvency proceedings. The addition of the applicant as defendant is rendered as necessary even further since the claim at issue concerns assets which are (or were) under the control of the applicant in such a way that the application influences directly both the legal rights and financial interests of the Branch. The applicant is a person whose powers and exercise of duties as special administrator will be directly influenced by the issuance of a judicial judgment in the present action and (unless the resolution order at issue is annulled by Court or revoked by the Central Bank of Cyprus), this will continue to bring about the legal consequences emanating from the Resolution of Credit and other Institutions Law 17(I)/13.”*

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Similar was the approach of the English Court on the Special Administrator’s role who *“...is responsible to husband, marshal, and preserve the assets for creditors and depositors. ... The burden is an extremely heavy one, not just a duty to depositors and creditors, but an onerous public duty to ensure the financial integrity...”*. In the Judge’s words upon setting aside a judgment issued in favour of a depositor of the Cyprus Branch whereas the Special Administrator has not been notified: *“... it is almost inevitable to infer that this was a cynical attempt to steal a march on the bank, not just to steal a march on the bank, but on the other creditors and depositors to put themselves higher up the priorities than they had any right to be...”*

The Resolution law and regulations remain to be tested further. Following the revocation of the bank’s licence an application has been filed for the special liquidation of FBME Bank, the Tanzanian parent undertaking of the Cyprus Branch and is currently in the process of final hearing before the District Court of Nicosia.

For further information on this topic please contact Dr. Pavlos Neofytou Kourtellos at P. N. KOURTELLOS & ASSOCIATES LLC, by telephone (+357 25 745575) or by fax (+357 25 755525) or by e-mail (pnk@kourtelaw.com)

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