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The First Resolution Experiences in the Context of BRRD – the National Perspetive

Second Session – Management of Banking Crises

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I – Introductory Remarks

- **As evidenced by the first resolution experiences in the context of BRRD resolution measures have the widest implications for a vast range of legal rights and interests**
- **There is an inherently contradictory feature in resolution measures – At the same time (i) these are envisaged and conceived towards the safeguard of the stability of the financial system as whole and, conversely, (ii) these measures, by their very nature, have a significant potential for disruption that has to be duly contained and monitored.**
- ***How do we set the legal pendulum for a proper balancing exercise between these two contradictory features, maximizing the positive, prevailing/stabilizing effects intended with resolution regimes?***
- **(1) Due process in the adoption and implementation of resolution measures involving adequate procedural safeguards and a (2) proper system of review of resolution measures are an essential part of the Answer.**

I – Introductory Remarks - cont

- **As regards these TWO ESSENTIAL CONDITIONS for a successful resolution regime – (1) Due process in the adoption and implementation of resolution measures involving adequate procedural safeguards and a (2) proper system of review of resolution measures, National experiences of EU Member States provide interesting lessons**
- **Accordingly, in the complex legal fabric of banking resolution in the EU, with a complex architecture, attention should be paid, for a critical assessment and consolidation of the regime, not only to SRB decisions/actions and the Court of Justice of the EU (CJUE) but also to national resolution authorities and national Courts**

I – Introductory Remarks - cont

- In the context of Banking Union if we compare the **SSM** and the **SRM** the **National Dimension** is far more important in the SRM – a number of reasons for that…
- Accordingly **significant relevance of national prcedents in implementation of resolution measures**
- Extreme relevance of a very recent precedent – probably first full blown precedent on the widest range of legality issues of BRRD-type resolution measures in EU legal environment – **Ruling of 12 March 2019 of Administrative Court of Lisbon** assessing BES resolution measures under a so called '**pilot procedure**' aggregating administrative judicial proceedings pending in such Court and concernning BES resolution and **construed to have precedent value on new legal issues for the remaining litigation**

I – Introductory Remarks - cont

- **In a nutshell**, first banking resolution experiences developed within what we may designate as ***BRRD paradigm*** matter - wider lessons may be derived from those **first cases at national level**, but bringing forward issues that will be at the core of the implementation of the SRM
- **<u>Twofold approach</u>**:
- **(A)** Focus on cases that have involved all the stages of application of resolution regimes – comprehending **key cycles of ex post judicial litigation**

I – Introductory Remarks - cont

- **(B)** Focus on what we may designate here as ***post-resolution stages*** - taking place after resolution intervention has been formally concluded, but with the intervened banking institution, or entities arising from such intervention, going through procedures and incidents which still relate with the resolution intervention stage
- Paradigmatic case – Appeal of Millenium BCP – August 2017 - against National Resolution Fund and Bank of Portugal (to be referred – infra VI) after the sale of the bridge bank arising from resolution (Novo Banco)

I – Introductory Remarks - cont

- **A step back to set the scene**: Within this overall view of input to be received from NATIONAl resolution cases - **a case stands out – Banco Espírito Santo (BES) resolution case in Portugal.**

- This BES case in Portugal represents a key precedent in the EU in terms of **economic and legal issues arising from BANKING RESOLUTION**, as regards **(a) PROPORTIONALITY issues**; **(b)** related **due process/procedural safeguards** and **(c) judicial review**

II - The BES case - a major precedent

- BES resolution case can be construed as major CASE STUDY for understanding the NEW issues arising from SECOND GENERATION RESOLUTION REGIMES – even if related with OLD Principles of EU legal System and of the Constitutional order of EU Member States – mainly PROPORTIONALITY
- **Why so Important CASE STUDY for the EU? (a couple or reasons:**

- **1** –A case which, given its huge dimension in Portugal and the elements of innovation it entails in the legal system, is currently submitted to **intense and widespread judicial scrutiny** – 24 very complex Appeals challenging the Resolution measures pending in Portuguese Administrative Courts (beside other related litigation)

II – The BES case – a major precedent - cont

- **(1) (cont) Judicial scrutiny focus on proportionality**
- The central question - why and in what sense does ***proportionality*** matter. It may be asked if substantive corollaries may in fact be extracted from ***proportionality*** **parameters** for purposes of scrutiny of resolution measures and for assessing the overall balance and efficiency in the implementation of a resolution regime that follows a ***BRRD paradigm***, referring here to parameters of ***proportionality*** as consistently brought forward in matters pertaining to **technical discretion in banking (including resolution**) in various ECJ precedents (*e.g.* in its 2016 rulings in Case C-526/14, "*Tadej Kotnik and others v Državni zbor Republike Slovenije*" or in Joined Cases C-8/15 and C-10/15 "*Ledra Advertising Ltd and Others v European Commission and European Central Bank*")
- **BES judicial precedent provides some anwers**…

II – The BES case – a major precedent

- **Why so Important CASE STUDY for the EU? (a couple or reasons: (cont.)**
- **2** – Also multiple judicial cases pending in various Portuguese Courts raising related **Liabilitiy issues agains supervisory and resolution authorities**

- **3** - A large bulk of cases pending in **Portuguese Administrative Courts** have been initiated by shareholders and creditors of BES against the resolution measures adopted in August 2014 by the Bank of Portugal - **Also cases reaching UK jurisdiction** – although of a diferent nature/scope involving decisions subsequent to the resolution and ajusting the perimeter of assets transferred (**or not**) to the **bridge bank/or conversely** allocated to the **Bad Bank**.

II – The BES case – a major precedent

- **Why so Important CASE STUDY for the EU? (a couple or reasons: (cont)**
- **4.1. –** Furthermore, also reaching for the **UK jurisdiction** Goldman Sachs International and a group of Investors attempted to bring claims worth around $850 million against Novo Banco (the **Bridge bank** established within the Resolution of BES).
- **4.2. -** These claims **related to obligations of BES under a** facility agreement with Oak Finance, which included an **English jurisdiction clause**. The investors argued that these obligations had been transferred to Novo Banco as a result of the actions of the Bank of Portugal; while Novo Banco and the Bank of Portugal argued that these obligations had not been transferred and therefore remained with the **Bad Bank** in the wake of the resolution of BES.

II – The BES case – a major precedent

- **4.3. -** This originated a **landmark precedent** in terms of resolution cases with impact on various EU Member States jurisdictions and with **corollaries for standards of JUDICIAL REVIEW** with **final ruling, of July 2018**, of **UK Supreme Court**
- **4.4.1. –** In fact, while in August 2015, the UK High Court ruled in favour of Goldman Sachs and the investors in matters of **jurisdiction**
- **4.4.2. – In November 2016 -** the **UK Court of Appeal (the quality of UK judicial system will be missed if and when Brexit materializes!)** unanimously decided that the High Court judge should not have done so. As a matter of Portuguese law, Novo Banco (**Bridge Bank** arising from resolution) is not a party to the Oak Finance facility agreement and does not owe any money. Any challenge to this position therefore had to be brought in the Portuguese courts, - Lord Justice Moore-Bick, giving the judgment of the **Court of Appeal.**

II – The BES case – a major precedent

- **4.4.3. –** According to the **UK Court of Appeal**, It was irrelevant for the purposes at stake that the obligations in the Oak Finance facility agreement were governed by English law, as, giving effect to the Bank of Portugal's resolution measures meant that the agreement did not bind Novo Banco (the new Bridge bank arising from BES resolution). Recognising this was "*fundamental to the scheme adopted by the EU for dealing with the widespread and potentially disastrous consequences of the failure of a major financial institution*"

II – The BES case – a major precedent

- **4.4.4.** – Also according to **UK Appeal Court November 2016 landmark ruling**:"[*T]he fundamental principle underlying the reorganisation and winding up of financial institutions within the European Union is that* ***it is for the home member state to decide how to deal with a failing institution*** *and that* ***its decisions are to be accorded universal recognition***"

- *"If that object is to be achieved it is essential that* ***Member States give reorganisation and resolution measures the effect which they have under the domestic law of the home state.***"

II – The BES case – a major precedent

- And "*If in the present case it were open to the English courts to hold that the effect of [the decisions taken by the Portuguese central bank] is other than that which it has under Portuguese law … there would be a* ***violation of the principle of universal recognition*** *on which the law in this area is based. Moreover …* ***it does not follow that a decision which does not fall within the scope of the [Recovery and Resolution Directive] cannot amount to a reorganisation measure and so be entitled to universal recognition for that reason alone***" (** - 2014 BES resolution measures were based on rules adopted previously to the transposition of BRRD)
- **Other relevant issues in this November 2016 UK Court of Appeal ruling which makes interesting Reading: - http://www.3vb.com/images/uploads/vcards/Guardians_of_New_Zealand_v_Novo_Banco_Approved_Judgment-1.pdf**

II – The BES case – a major precedent

- The July 2018 UK Supreme Court concurred essentially with this line of reasoning

- In light of this most import precedent, the ability of parties to conduct forum shopping, *e.g.* through the complexity of certain legal instruments, is henceforth seriously limited, due to **public order principles** arising from the **BRRD resolution system** requiring, as much as possible, unity of enforcement at the level of the home Member state of the resolved entity

III – Review of BES resolution – Some major issues

- The dozens of cases pending in **Portuguese Administrative Courts** on BES resolution raise *inter alia* issues of constitutionality of the measures adopted and of the underlying regime and - without entering here into undue details (for reasons of professional secrecy and others, involving cases not closed) – such cases also try to approach/assimilate RESOLUTION to some traditional forms of curtailing property rights, such as **(i)** Expropriation, **(ii)** Nationalization and **(iii)** Confiscation – with the corresponding specific procedural safeguards…

III – Review of BES resolution – Some major issues

- In a nutshell – and not disclosing here details – at the very core of such discussion of RESOLUTION vis a vis Expropriation, Nationalization and Confiscation in the context of the Economic Constitution are problems related with the **compression of property rights** and **patterns** to deal with these rights vis a vis the overriding requirements of **public interest** that justify **intervention** in banks.

- **…And, largely underlying such discussion on property rights is the pondering of the Proportionality Principle and the corresponding procedural safeguards attached to it….**

III – Review of BES resolution – Some major issues

- The final judicial outcome of these multiple cases which will end forseeably at the **Portuguese Supreme Administrative Court** (and **Constitutional Court**?) will form in years to come a **fundamental body of law** to **discuss**...
- ...the **contents/patterns/limits of exercise** of **public powers of resolution** *with a relevance that will very largely transcend the Portuguese jurisdiction....*
- Also because the 2012 national legislation on which BES resolution was based essentially anticipated a BRRD framework and **BES** can be regarded as **the first major resolution experience to be completed** – *in its various cycles/including related ex-post litigation* – **in the context of BRRD**

III – Review of BES resolution – Some major issues

- ***Recent development within this legal complexity – leading to the landmark Pilot Case Ruling of 12 March 2019*** - *in May 2017* – the **Administative Court of Lisbon,** using a particular rule (article 48) of the Portuguese Code of Procedural Rules of Administrative Courts for the decision of ***mass cases based on similar legal grounds***, decided to rule on one of the specific cases pending (in which *inter alia* the nulity of the August 2014 resolution deliberations of the Bank of Portugal was required);
- Effectively **suspending** the dozens of (other) judicial cases also pending at the same Court with a similar request, **in order to avoid contradictory judicial rulings**.

IV – Legal Issues in BES and Proportionality

- IN BES resolution case, despite initiated under Portuguese legislation adopted **before** formal transposition of BRRD, all pieces of the legal and economic PUZZLE of **exercise of resolution powers interfering** with **PROPERTY** under the test of **PROPORTIONALITY** were in place – and lessons to be learned from extensive litigation in the case will be lessons to the EU too…

- **Why proportionality matter? - Let's phrase – oversimplifying - the key question under discussion:**

The significant ***interference*** *with* ***property rights*** *(abstaining here, for now, from further Legal Qualifications of such '****interference****') and its* ***related procedural safeguards*** *- entailed by resolution rules - raises the fundamental question whether*

that can be justified consistently with constitutional guarantees – fundamental issue addressed in the 12 March 2019 Pilot Ruling case

IV – Legal Issues in BES and Proportionality

- Proportionality parameters in the formal path/procedure to adoption of resolution measures involve **wide Margin of appreciation** for resolution authorities and supervisors ("Grainger" precedent - "Grainger v UK", European Court of Human Rights - ECtHR 10 July 2012 (Application No 34940/10))

- YES – but considerable difficulties ahead of us to consolidate/densify **Proportionality parameters** and **corresponding safeguards** in Banking RESOLUTION interventions…
- Conversely, ***Proportionality*** *should not be taken as a* ***hollow principle*** *and may/should be construed as an actual basis for effective judicial review of resolution decisions* – Uncharted waters to be tested in the case law of various national/EU Courts – Outcome of BES litigation to provide very important indicators in this domain for densification of proportionality – **Key indicators in the Pilot Ruling of 12 March 2019.**

IV – Legal Issues in BES and Proportionality

- *There is a number of inevitable/inescapable* ***LEGAL COMPLEXITIES*** in deciphering and using properly the **Margin of Appreciation** recognized to resolution authorities when applying **Proportionality Parameters** at the very core of the adoption of resolution measures, with the corresponding **procedural safeguards** and – as such – potentially relevant for purposes of **Judicial Review**.
- *We are destined* ***to discuss (inter alia) 3 MAJOR ISSUES on Proportionality vs Resolution*** *in years to come…* ***and BES litigation provides some indicators on such issues…***

IV – Legal Issues in BES and Proportionality

- **Legal Complexities**/Destined to discuss **3 MAJOR ISSUES**:
- I – No Mandatory scale to be sequentially followed of early intervention measures/preventive and corrective measures of supervisory authorities before resolution measures adopted towards a bank in distress (***differently from what was alleged in BES judicial Court cases***) – **Margin of appreciation** for direct recourse to Resolution within the circumstances but ENOUGH GROUNDS identified/stated for such decision while assessed under URGENCY Constraints – Dilemmatic Assessment : Enough Grounds vs Urgency (**close call**…)

IV – Legal Issues in BES and Proportionality

- **Legal Complexities**/Destined to discuss **3 MAJOR ISSUES**:

- **II** – Finetuning the **characterization of the nature** of **write down or conversion of assets/credits** through bail-in as deprivation (**or not**) of property/possession in comparison e.g. with Expropriation (**a paralell raised in the BES litigation**) – and Consequences in terms of Compensation/ ** Sustainable view: *There is* ***no definitive transfer of property to the public sphere*** *but a* ***public intervention which ultimately should not alter the situation of affected shareholders/creditors in comparison with what would have resulted from normal insolvency proceedings*** – applying the "no creditor worse off" to write down and conversion instruments - compensation if bail-in imposed a greater loss on them

IV – Legal Issues in BES and Proportionality

- **Legal Complexities**/Destined to discuss **3 MAJOR ISSUES**:

- **II (Cont.)** – Anyway, this implies a somewhat broad Reading of the applicable resolution rules through which *the "no creditor worse off" principle applies not only to* ***resolution tools and powers*** *but also to* ***write down and conversion instruments***
- However, great **difficulty** of assessing **ex ante** the consequences of highly complex insolvency proceedings (and complex problems of evaluation criteria for purposes of application of *"no creditor worse off" – no space to cover these here (...))*

IV – Legal Issues in BES and Proportionality

- **Legal Complexities**/Destined to discuss **3 MAJOR ISSUES**:

- **II (cont.) – BUT, how will those *difficulties* be reflected in the stance of resolution authorities?**
- (A) Overcaution here to avoid future litigation risks?
- (b) Or, more affirmative action, passing on the potential problems to the **relevant financial arrangements/resolution funds** (then confronted with the need to pay **compensation** if the no creditor worse off" principle is not ultimately respected) – **conversely, associated Risks of financial overburden or losses of resolution funds**…

- *** *In a nutshell - need to find and calibrate an appropriate but much difficult Balance here…*

IV – Legal Issues in BES and Proportionality

- **Legal Complexities**/Destined to discuss **3 MAJOR ISSUES**:

- **III (third set of issues) – Difficulties** in **pondering the specific Resolution TOOLS – Proportionality** also involves **graduating the Less Intrusive resolution TOOLS** – within the palette of appropriate resolution measures chosing "*la moins contraignante*" – BUT- Prospetive reasoning – (a) developed in abstracto/ex ante (albeit in light of relevant circumstances), while (b) assessed/checked ex post (in possible judicial challenges as evidenced in the BES case) – **Necessary/complex BALANCE here - *What will be the Balance in future judicial scrutiny??* – stay tooned with BES case...and key indications from recent March 2019 Pilot Ruling of Lisbon Administrative Court...**

V – Pilot Ruling (Adm Court Lisbon) 12 March 2019 – key aspects

- Dense/complex ruling – almost 250 pps ruling dealing with alegged issues of **constitutionality** of BES resolution measures – leaving aside formal and organic constitutionality and focusing here on so called **material constitutionality**, we may refer:
- (a) breach of principles of **equality and fair compensation;**
- (b) breach of **rights to (and corresponding safeguards) private property**

V – Pilot Ruling (Adm Court Lisbon) 12 March 2019 – key aspects - cont

- Dense/complex ruling – dealing with alegged issues of **legality** of BES resolution measures:
- Breach of principle of proportionality
- Breach of principle of good faith and protection of legitimate expectations
- Decision on resolution non duly grounded
- Breach of principle of impartiality

V – Pilot Ruling (Adm Court Lisbon) 12 March 2019 – key aspects - cont

- Conclusive answer by the Court (ruling by unanimity) **rejecting all such issues of <u>constitutionality</u> and <u>legality</u>**
- No breach of rights of private property – there was no unduly compression of property rights but a natural exposition to the conditions of a liquidation stemming directly from the status held (shareholder/subordinated credor etc) with corresponding consequences also occuring in a resolution procedure (as an alternative procedure to liquidation) - p 225 5§ of the ruling

V – Pilot Ruling (Adm Court Lisbon) 12 March 2019 – key aspects - cont

- **Necessity of resolution** – duly grounded – merely hypothetical and non realistic any alternative scenario to liquidation/ as from the analysis of Bank of Portugal duly evidenced no alternative solutions aside liquidation – not reasonable to require explicit assessment of **all other hypothetical alternatives**...p 213 §1 of ruling
- Risks of contagion/spill over to other financial institutions in liquidation alternatives...p 213 §1 and p 212 §1 of ruling
- Bank of Portugal duly stated reasons on **factual grounds and legal grounds** for the decision of resolution
- **Reasonability - balancing exercise** reasonable/balanced pondering of negative consequences of liquidations vis a vis benefits of resolution – p 244 § 1, 2 and 3 of ruling

VI – Issues on post-resolution stages

- Appeal to the Administrative Court of Lisbon, of August 2017, brought by a bank operating in Portugal (*Millenium*) against the National Resolution Fund (NRF) and the Bank of Portugal [as national resolution authority (NRA)] challenging one of the clauses of the sale agreement of *Novo Banco* (bridge bank arising from BES) to a third entity (*Lone Star*) and challenging, to the extent these approve such clause, the acts of NRF and the NRA
- The clause at stake concerned a mechanism of **contingent capitalization**, establishing that the NRF may inject funds (up to a maximum extent) in case of underperformance of certain assets of *Novo Banco* and underperformance of levels of capitalization of *Novo Banco*. *Millenium*, participating in the Portuguese resolution fund (NRF), challenged this mechanism arguing, *inter alia*, *non-proportionality* of further financial efforts of the resolution fund and its participating banks **after the sale of bridge bank** (thereby raising what may adequately be designated as '*post resolution issues*'

VI – Issues on post-resolution stages - cont

- While the basis for such judicial challenge seems to be highly debatable, since it is conceivable that bringing together the proper conditions to successfully closing a resolution process through the actual sale of a bridge bank (arising from resolution) may justify certain commitments of the applicable resolution fund, that make viable such sale (provided a duly pondering of the alternatives has taken place and proper and balanced justifications are evidenced for the scenario chosen to effectively close resolution), the case illustrates the **diversity of levels of judicial review** that may result from resolution measures, including review concerning potential interventions of resolution funds **after** the **executive resolution** process has been **closed**

VII - Concluding…

- Key Reference to this Presentation: Luis Silva Morais – ***Lessons from the First Resolution Experiences in the Context of Banking Recovery and Resolution Directive*** – in **The Palgrave Handbook of European Banking Law**, Edited Mario Chiti/Vittorio Santoro, 2019, pp 371 (*although Chapter not including references to the* ***Pilot Ruling of Administrative Court of Lisbon, of 12 March 2019***)

- As I believe is commonly said in Italy: "***Il bisogno fa l'uomo bravo***" – *translating/adapting freely: Necessity brings about groundbreaking solutions….*

VII - Concluding…

- …And **Resolution** is really a domain of **uncharted legal waters** in which **necessities of stabilization of financial system** originate **innovative** and **groundbreaking solutions** – which conversely must be **balanced** and **cope with key legal principles**….
- **First concluded resolution experiences** following a BRRD paradigm should evidence that balance…
- **THANK YOU FOR YOUR ATTENTION**